LIMITS ON REGULATORY POWERS UNDER THE BANKRUPTCY CODE

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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TUESDAY, APRIL 11, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to call, at 2 p.m., in Room 2237 Rayburn House Office Building, Hon. George W. Gekas [chairman of the subcommittee] presiding.

Present: Representatives George W. Gekas, Lindsay O. Graham, Steve Chabot and Jerrold Nadler.

Also present: Representative John Conyers Jr,.

Staff present: Raymond V. Smietanka, Subcommittee Chief Counsel; Susan Jensen-Conklin, Counsel; Sarah Zaffina, Staff Assistant; Perry Apelbaum, Minority General Counsel; and David Lachmann, Minority Professional Staff Member.

OPENING STATEMENT OF CHAIRMAN GEKAS

Mr. GEKAS. [presiding] The hour of two o'clock having arrived, the Committee on Commercial and Administrative Law shall come to order. But pursuant to the custom of the Chair and the rules of the House, we cannot proceed until a second member appears to constitute the hearing quorum.

The custom in which the Chair is engaged is to hit the gavel at the appointed hour, even if we then have to take a nap until the next member appears for the panel. And, so pending that, I ask the witnesses to be patient, even more patient than they have already been, and we will recess until the appearance of a second member.

[Recess.]

Mr. GEKAS. The presence of the gentleman from New York now being noted, the required quorum is present, and the hearing can proceed.

As everyone knows, the subject matter is the story of two interests: That of the debtor in bankruptcy and the creditor in bankruptcy. We have heard that story repeatedly throughout the last 3 years in various degrees. But this issue is so complex and so, how shall I say, different from any that this member has ever encountered, that I am eager to hear the witnesses' testimony. It has that government/private sector flavor that befuddles us on a normal basis.

Whether or not the regulatory agency that involves itself in this process, in the bankrupt process, is doing it for regulatory purposes or for collection purposes is a groundwork issue; we understand that. And the relative rights then of a debtor become inflamed when some other action is trying to be accomplished by a regulatory agency.

And, so we don't know where we are on the issue—I don't. Maybe the gentleman from New York knows where he is, but I don't. And, therefore, the testimony is going to be very valuable in trying to sort it all out. We do have an open mind on this question, because there is nothing in our minds that can start to approach the vagaries of this particular issue.

So, with that, I will be glad to render to Mr. Nadler the microphone for an opening statement.

[The prepared statement of Mr. Gekas follows:]

PREPARED STATEMENT OF HON. GEORGE W. GEKAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Today we focus on one of the more intriguing issues presented in the bankruptcy forum. This issue concerns two competing interests: ensuring that regulatory enforcement efforts are not impeded by debtors who use bankruptcy as a sword to defeat those efforts and ensuring that regulatory enforcement actions are not used as a cover to obfuscate what are inherently creditor collection efforts.

Clearly, bankruptcy should not be a refuge or a haven for law breakers. To that end, the current bankruptcy law specifically excepts certain types of law enforcement proceedings from the broad reach of the automatic stay. The automatic stay, as we know, is one of the most fundamental provisions in the Bankruptcy Code. It ensures that bankruptcy assets are protected and maximized for the benefit of creditors by preventing their dissipation through the proverbial race to the courthouse. In general, the automatic stay ensures that all similarly situated creditors are treated equally and fairly in a bankruptcy case. The automatic stay also gives the debtor a financial "breathing spell" during which the debtor can focus its resources on reorganization instead of defending creditor collection proceedings.

While the law is generally clear that regulatory enforcement proceedings are not enjoined by the automatic stay, there are instances when a governmental agency attempts to assert that its actions are intended for regulatory enforcement, when in fact they are simply creditor collection efforts.

Several recent bankruptcy cases involving certain spectrum licenses illustrate the clash of competing interests presented by the automatic stay and regulatory enforcement efforts. These cases have generated much interest in the bankruptcy and regulatory communities as well as in the telecommunications industry. In addition, they have caused at least one federal agency, namely, the Federal Communications Commission, to seek legislative relief in prior years.

Our hearing today will hopefully lead to greater understanding of the issue and the competing concerns as analyzed by our esteemed panelists.

Mr. NADLER. Thank you very much, Mr. Chairman. I know that some people in the public might think that with respect to Members of Congress there is nothing much in our minds. I am glad you qualified that statement with the end of the sentence by saying with regard to a specific issue.

Let me say that this committee and this subcommittee have been struggling in general with the bankruptcy code for the last, I think, 3 years quite contentiously. The chairman and I have not agreed on some of those issues, to put it mildly. I hope that on this issue, which is a relatively unprecedented, as far as I know, a very new challenge to the automatic stay to most of the concepts that we normally think of as central to bankruptcy law.

It is a new idea with regard—I think it is a new idea with regard to what the limits of the automatic stay and the privileges of government agencies superseding the normal considerations of bankruptcy law, and I hope we will take a fresh look at this and consider whether it makes a sense as a policy matter as well as a legal matter to allow this rather major limitation on what we have always considered normal bankruptcy law and the automatic stay. For myself, I have a somewhat open mind, but I am very skeptical, I must tell you.

And I want to commend the chairman for scheduling this hearing soon enough in the process so that if the committee determines that some action might be taken legislatively, we still have time to do it this year. So, we will listen with open ears and hopefully open minds, and I thank the chairman.

Mr. GEKAS. We thank the gentleman, and we will proceed with the introduction of our witnesses who constitute the first panel. Ethan Posner currently serves as Deputy Associate Attorney General at the Justice Department where he has oversight responsibility for matters arising from the Anti-trust and Civil Divisions, as well as responsibility for many civil justice and civil enforcement issues, including bankruptcy.

Prior to joining the Department of Justice, Mr. Posner was a partner in the Washington D.C. law firm of Covington and Burling, specializing in complex civil litigation. Mr. Posner is a 1989 graduate of the University of Michigan Law School where he was a senior editor of the Law Review. He also served as a Judicial Clerk for Judge Harrison Winter on the U.S. Court of Appeals for the 4th Circuit.

He is joined at the witness table by Christopher Wright, the General Counsel of the Federal Communications Commission, a position he has held since 1997. Previously, he was the Deputy General Counsel for 3 years before being appointed to his current position. His responsibilities include providing advice to the Commission regarding significant legal issues and enforcing the Commission's orders in the courts.

Before joining the Commission, Mr. Wright spent 9 years in the Solicitor General's Office where he argued 27 cases before the Supreme Court. He also spent 2 years in private practice at Shea & Gardener. Mr. Wright served as a law clerk to Judge Joseph T. Snead of the 9th Circuit and to Chief Justice Warren A. Burger. He graduated from Harvard College and Stanford Law School.

We will begin the testimony in the order in which the witnesses were introduced. We will tell them that their written statements will automatically become a part of the record. We ask each witness to restrict the oral testimony to about five minutes, but we will not strangle the witness if he goes a little beyond that deadline.

So, we will begin with Mr. Posner, five minutes.

STATEMENT OF ETHAN POSNER, DEPUTY ASSOCIATE ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. POSNER. Mr. Chairman and Congressman Nadler, good afternoon

I appreciate the invitation to provide the Department of Justice's views of the police and regulatory exception to the bankruptcy automatic stay. The Department of Justice, and the public at large, have a strong interest in this exception, as it protects vital public safety and regulatory interests by ensuring that bankruptcy does not afford a haven for wrongdoers and those who violate Federal or State regulatory laws and programs.

We believe that the current Bankruptcy Code strikes an appropriate balance between protecting the public interest and recognizing the primacy of important regulatory functions, on the one hand, and promoting the needs of debtors and creditors in the bankruptcy process, on the other hand.

The police and regulatory exception, codified at section 362(b)(4) of the Bankruptcy Code, provides, as the chairman and Congressman Nadler know, that the automatic stay does not extend to the commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers.

Thus, for example, Federal and State governments may enforce and pursue actions under the environmental laws or the labor laws against the debtor, whether those actions were filed before or after the bankruptcy petition. Similarly, regulatory agencies, both State and Federal, may enforce their regulatory programs against debtors. Section 362(b)(4) provides regulatory authorities with the necessary flexibility to protect the broad public interest that may be threatened by the financial instability of a single entity.

In the Department's view, if the Bankruptcy Code did not so provide, the bankruptcy process could be used as a shield, immunizing debtors from actions that protect public safety and enforce important and long-standing regulatory priorities.

It is important to recognize that the police and regulatory exception is not unlimited. Federal and State governments and regulatory agencies may not use the exception to enforce a money judgment or pursue a collection action without first obtaining relief from the bankruptcy court. Over the past 20 years, the police and regulatory power exception has been applied to permit governmental units to pursue actions that protect the public and vindicate important regulatory priorities.

Let me provide a few quick examples. First, numerous courts have refused to stay actions requiring a debtor to abide by Federal and State environmental laws that require clean-up of hazardous waste materials, and the distribution of clean drinking water. Courts have refused to stay or interfere with those actions.

Second, courts have refused to interfere with actions that vindicate important regulatory interests. A unanimous Supreme Court made that clear in the *MCorp.* case, a 1991 decision holding that the automatic stay did not shield a debtor bank from pre-bankruptcy regulatory proceedings instituted by the Federal Reserve Board. The Supreme Court explicitly rejected the argument, advanced by the debtor in that case and by others more recently, that the regulatory action could proceed only if the bankruptcy court first determined whether the proposed exercise of the police or regulatory power was legitimate.

Writing for a unanimous court, Justice Stevens stated that a broad reading of the stay provision would require bankruptcy courts to scrutinize the validity of every administrative or enforcement action brought against a debtor. That scrutiny, the court unanimously concluded, conflicts with the broad discretion Congress has expressly granted many administrative entities and conflicts, the court noted, with the limited authority Congress has vested in bankruptcy courts.

In several other cases, the courts rejected efforts to delay or interfere with an action by the FAA to allocate critical landing slots in the face of a challenge by bankrupt airlines. Critically, these and other cases recognize that the police and regulatory exception applies even if the regulatory action impacts the property or assets of the estate. Indeed, many actions undertaken by a regulator may have the effect of impacting the property of the estate, but that cannot be sufficient to justify the operation of the stay.

One of the most recent examples of a court recognizing the primacy of important regulatory functions, of course, occurred in the *Nextwave* case, decided by the 2nd Circuit Court of Appeals in December of 1999. That case, as the committee knows, held that the bankruptcy judge had no authority to interfere with the FCC's exclusive authority to regulate the radio spectrum and established a process to select and allocate licenses.

Although the court did not cite section 362(b)(4) as the basis for its decision, it did conclude that important regulatory interests must prevail over the interests of an individual debtor. That principle, which the Department of Justice strongly supports, is at the heart of the police and regulatory exception.

In sum, Mr. Chairman and Congressman Nadler, we believe that the police and regulatory exception protects public safety and vindicates important regulatory interests. The Department of Justice would oppose any effort to narrow or restrict section 362(b)(4) or any other provision of the Bankruptcy Code or other law that would undermine the important principles on which the police and regulatory exception is based.

Mr. Chairman, Congressman Nadler, thank you for the opportunity to present the views of the Department of Justice on this important topic, and I would be pleased to answer questions that you may have.

[The prepared statement of Mr. Posner follows:]

PREPARED STATEMENT OF ETHAN POSNER, DEPUTY ASSOCIATE ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. Chairman, Congressman Nadler, and Members of the Subcommittee:

I appreciate the invitation to provide the Department of Justice's views of the police and regulatory exception to the bankruptcy automatic stay. The Department of Justice—and the public at large—have a strong interest in this exception, as it protects vital health, safety, and regulatory interests by ensuring that bankruptcy does not afford a haven for criminals and the violators of federal or state regulatory laws and programs. We believe that the current Bankruptcy Code provisions strike an appropriate and important balance between protecting the public interest and recognizing the primacy of important regulatory functions, on the one hand, and promoting the needs of debtors and creditors in the bankruptcy process, on the other hand.

I. THE AUTOMATIC STAY AND THE POLICE/REGULATORY EXCEPTION

Under section 362 of the Bankruptcy Code, upon the filing of a petition for bankruptcy, the debtor is entitled to an automatic stay from adverse creditor actions. As the legislative history to this section recognizes, the automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his or her creditors; and it stops collection and foreclosure efforts, enabling the debtor to reorganize her finances or businesses and/or liquidate assets in a rational manner. The automatic stay also benefits creditors by promoting the orderly administration of the estate as well as the bankruptcy policy of equality of distribution among claimants.

But the Bankruptcy Code also recognizes a very important set of exceptions to the automatic stay. "Congress recognized . . . that the stay provision was particularly vulnerable to abuse by debtors improperly seeking refuge under the stay in an effort to frustrate necessary governmental functions." *United States* v. *Nicolet, Inc.*, 857 F.2d 202, 207 (3d Cir. 1988). Under section 362(b)(4) of the Code, the automatic stay for the debtor does not extend to the commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers. Thus, for example, federal and state governments may enforce and pursue actions under the criminal, environmental, or labor laws against the debtor or the estate—whether those actions were filed before or after the bankruptcy petition. Similarly, regulatory agencies such as the FCC or FAA, so long as they act in their regulatory capacity, may enforce their regulations and regulatory programs against debtors. To prevent governmental and regulatory agencies from doing so would transform the bankruptcy process into a shield, immunizing debtors from actions that protect public safety and enforce important and longstanding regulatory priorities.

Recognizing these fundamental interests, in 1998 Congress confirmed that the police and regulatory exception permits police and regulatory actions against estate property. Although applicable generally, the clarification was enacted in a bill to implement the United States' obligations under the Chemical Weapons Convention. The 1998 amendment ensured that dangerous chemicals banned by the Convention could be seized without awaiting permission from the bankruptcy court. Securing bankruptcy court permission requires formal and often time-consuming legal action. Such delay in seizing hazardous materials obviously places the public at risk. For this reason, we strongly supported the 1998 amendment confirming the broad scope of the police and regulatory exception.

The police and regulatory exception is not unlimited, however. Federal and state governments may not, for example, use the exception to enforce a money judgment without first obtaining relief in the bankruptcy court. Thus, an appropriate balance exists between the public interest in regulatory enforcement and the interest of the bankruptcy court in managing the finances of the debtor.

II. APPLICATION OF THE POLICE AND REGULATORY EXCEPTION

The ways in which the police and regulatory exception have been applied in practice is perhaps the best illustration of its importance. Over the past 20 years, the police and regulatory power exception has been applied to permit governmental units to pursue actions that protect the health and safety of the public, including environmental enforcement actions, labor law enforcement actions, employment discrimination enforcement actions, and medical license revocation proceedings. Similarly, the regulatory aspect of the police and regulatory exception has been applied broadly to require the enforcement of many important regulatory priorities. The Securities and Exchange Commission, for example, has relied upon the police and regulatory exception to maintain its enforcement actions to disgorge illicit profits and enjoin fraudulent activity.

A. Using The Police/Regulatory Exception to Protect Health and Welfare

Examples where the police and regulatory exception has been used to protect the health and welfare of the public include:

- an action by the Pennsylvania Department of Environmental Resources to require a debtor to comply with a pre-bankruptcy consent order to clean up the pollution on its property. The court refused to stay that action even though the debtor asserted that it would have to spend money to continue cleaning up its property. *Penn Terra Ltd.* v. *Department of Environmental Resources*, 733 F.2d 267 (3d Cir. 1984).
- United States could pursue action against debtor under the Safe Drinking Water Act to protect health and safety of residents. *United States* v. *Merritt*, No, 94–CV–026 (D. Wyo. 1994).
- an action by a state medical quality assurance board to determine whether a doctor's license to practice should be revoked. The doctor attempted to invoke the automatic stay but section 362(b)(4) was held to apply and the hearings proceeded. *Thomassen* v. *Division of Medical Quality Assurance*, 15 B. R. 907 (B.A.P. 9th Cir. 1981).
- an investigation by a state agency into age and sex discrimination and sexual harassment allegations. A debtor motel had sought to invoke the automatic stay to stop these proceedings but the court permitted them to proceed under

the police and regulatory exception. *In re Mohawk Greenfield Motel Corp.*, 239 B.R. 1 (Bankr. D. Mass. 1999).

- an employment discrimination action by the EEOC against the Rath Packing Company, which had sought to enjoin the EEOC after filing for bankruptcy. The Eight Circuit firmly rejected this effort, relying expressly on the police and regulatory exception. *EEOC* v. *Rath Packing Co.*, 787 F.2d 318 (8th Cir. 1984).
- a city's condemnation and demolition action, which had determined that a dilapidated building owned by the debtor posed a serious threat to the community. The debtor attempted to avoid the demolition by invoking the automatic stay but the court applied the (b)(4) exception. *Javens* v. *City of Hazel Park*, 107 F.3d 359, 365 (6th Cir. 1997).

These examples—all of which protected the public good—serve to illustrate the continuing importance of the police and regulatory exception.

B. Using The Police/Regulatory Exception to Further Important Regulatory Interests

The police and regulatory exception is not limited to actions taken to protect public health or safety. *See In Re Commonwealth Companies, Inc.*, 913 F.2d 518, 521 (8th Cir. 1990) (rejecting "view that section 362(b)(4) applies only to actions to protect public health or safety"); *In re Commonwealth Oil Refining Co.*, 805 F.2d 1175, 1184 (5th Cir. 1986) (exception is "not . . . limited to those situations where imminent and identifiable harm to the public health and safety or urgent public necessity is shown"), *cert. denied*, 483 U.S. 1005 (1987). Section 362(b)(4) also applies when a federal or state governmental entity seeks to vindicate and enforce regulatory powers. The Supreme Court made that clear in *MCorp* v. *Board of Governors of the Federal Reserve System*, 502 U.S. 32 (1991), holding that the automatic stay did not shield a debtor bank from pre-bankruptcy regulatory proceedings instituted by the Federal Reserve's Board of Governors, which sought to require the debtor to recapitalize its subsidiary banks in order to preserve the strength and safety of the federal banking system. In so holding, the Supreme Court rejected the argument, advanced by the debtor, that the Federal Reserve could proceed only if the bankruptcy court first determined "whether the proposed exercise of police or regulatory power is legitimate. . . ." 502 U.S. at 40. That "broad reading of the stay provision would require bankruptcy courts to scrutinize the validity of every administrative or enforcement action" brought against a debtor, the Court concluded. Such scrutiny "conflicts with the broad discretion Congress has expressly granted many administrative entities and [conflicts with] the limited authority Congress has vested in bankruptcy courts." 502 U.S. at 40.

Other cases in which important regulatory interests have prevailed over the interests of the debtor include:

- an action by the FAA to allocate critical landing slots in the face of a challenge by bankrupt airlines. The courts rejected efforts to delay or interfere with the FAA's regulatory proceedings. *In re Gull Air, Inc.*, 890 F.2d 1255 (1st Cir. 1989); *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983).
- an enforcement action by the Securities and Exchange Commission, which asserted that debtor Paul Bilzerian had committed violations of the securities laws. The bankruptcy court refused to invoke the automatic stay to block the SEC's regulatory action. *In re Bilzerian*, 146 B.R. 871 (Bankr. M.D. Fla. 1992).

Furthermore, section 362(b)(4)'s "regulatory power exception applies to acts by the government to obtain possession of property of the Bankruptcy estate or to exercise control over Bankruptcy estate property." *In re PMI-DVM Real Estate Holdings, LLP*, 240 B.R. 24, 30 (Bankr. D. Ariz. 1999). Indeed, "[m]any actions against a debtor taken under governmental police or regulatory power have the effect of controlling the property of the estate." *In re Javens*, 107 F.3d 359, 367 (6th Cir. 1997). As the Supreme Court concluded in the *MCorp. case*, the possibility that regulatory actions may conclude with the entry of an order that will affect the bankruptcy court's control over property of the estate "cannot be sufficient to justify the operation of a stay against" a regulatory action under section 362(b)(4). "To adopt such a characterization of enforcement proceedings would be to render subsection (b)(4)'s exception meaningless."

One of the most recent examples of a court recognizing the primacy of important regulatory interests occurred in *In Re Nextwave Personal Communications, Inc.*, 200 F.3d 42 (2d Cir. 1999), which involved the ability of the Federal Communications Commission to establish and enforce the terms under which certain C-block personal communications licenses would be auctioned and allocated. In the *Nextwave* *case*, the debtor filed for bankruptcy to avoid paying the $4.74 billion that it incurred by submitting winning bids for 63 licenses in the FCC's auction program. The bankruptcy judge voided $3.7 billion of this obligation and entered judgment permitting Nextwave to retain the licenses it had won at auction. On appeal, the Second Circuit concluded that the bankruptcy judge had no authority to interfere with the FCC's exclusive authority to regulate the radio spectrum and establish a process to select and allocate licensees. Although the court did not cite section 362(b)(4) as the basis for its decision, it did conclude that important regulatory interests must prevail over the interests of an individual debtor. That principle, which the Department strongly supports, is at the heart of section 362(b)(4).

III. THE JUSTICE DEPARTMENT WOULD OPPOSE ANY EFFORT TO NARROW OR RESTRICT THE POLICE AND REGULATORY EXCEPTION OR THE PRINCIPLES ON WHICH IT IS BASED.

The Justice Department strongly supports the police and regulatory exception in the Bankruptcy Code. We believe section 362(b)(4) protects public safety and vindicates important regulatory interests. The Department of Justice would oppose any effort to narrow or restrict section 362(b)(4) or any other provision of the Bankruptcy Code that would undermine these important principles.

Mr. Chairman, thank you for the opportunity to present the views of the Department of Justice on this important topic. I would be pleased to answer any questions you might have.

Mr. GEKAS. Thank you.

We turn to Mr. Wright.

STATEMENT OF CHRISTOPHER J. WRIGHT, GENERAL COUNSEL, FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, DC

Mr. WRIGHT. Thank you. Let me also thank you for my opportunity to testify here today.

As Mr. Posner's explained, section 362(b)(4) distinguishes regulators from creditors.

Mr. NADLER. Could you speak a little louder, please?

Mr. WRIGHT. Certainly.

The FCC has a narrower focus than the Department of Justice. We have been entangled in bankruptcy proceedings only on account of our auction program during the 6½ years I have been at the Commission. I think the most useful thing I can do is explain why the 2nd Circuit was right that we are properly viewed as a regulator rather than a creditor.

The key point I think I would like to make today is that we view auctions as a method of distributing spectrum licenses. We view them as an alternative to comparative hearings and lotteries. Distributing spectrum licenses has been one of the core missions of the FCC since we were created in 1934. From our perspective, it has always been a key function to make sure that there is not interference on the airwaves. And the way we do that is to license particular frequencies in particular areas.

Now, we didn't get auction authority until 1993. We held the world's first spectrum auction in 1994. But for 60 years before that we were distributing spectrum licenses. We think that the auction authority is a terrific way to distribute commercial licenses, and the reason we think that is because we think it is a superior way to identify, with respect to commercial licenses what party is most likely to put the spectrum to use efficiently and productively.

The 2nd Circuit said, quote "Our full and timely payment requirements have regulatory significance." It understood, as the bankruptcy court did not, that this is not primarily a means of raising money, from our perspective. It is a means of distributing licenses, of getting licenses into the hands of the party best able to use them. Again, from our perspective, the auction program sets up a market test to determine who best will use the license.

Now, in our world, in the FCC world, everyone knows that *warehousing* spectrum is tragic. We want more competition in the wireless industry. We are very proud that we ended the cellular duopoly a few years ago. We now have four or five wireless competitors in every urban market. Prices have gone down, service has improved on account of that. It is very frustrating from our perspective that a very valuable piece of spectrum has essentially been tied up bankruptcy proceedings and has not been used for a number of years for that reason.

We are about to launch an auction next month which we expect bidders will bid in order to provide high speed internet access by wireless means. We are very anxious to set up alternative paths to the internet. One of our problems with that auction is that, given that there is so little spectrum available, the users of that spectrum probably have to share it with television channels 60 to 69 for some time. Again, it is terribly frustrating when we want to get alternative means of access to the internet out there, that this valuable spectrum in the C Block has been tied up in bankruptcy.

In our view, all of the C Block bankrupts should have been treated the way Southeast Telephone was. Southeast, unlike Nextwave and unlike GWI, filed a request for a waiver with the Commission of the full and timely payment requirement. The Commission said, no, we're going to apply our rules, as they are written, and instead of going to bankruptcy court Southeast, went to district court. It actually went to two district courts, both in the 6th Circuit and in the D.C. Circuit.

Those courts properly rejected Southeast Telephone's arguments. We have already reauctioned Southeast's spectrum, and it is in the hands of someone who will put it to productive use soon. That is what we think should have happened in these bankruptcy cases. That is what would have happened if the bankruptcy courts had not rejected our argument that C Block licensees are properly reviewed with respect to the FCC as working with us in our regulatory capacity.

The Mountain Solutions case, decided by the D.C. Circuit in December, is another case where a court of appeals has "recognized the importance to the integrity of the auction process," quoting the D.C. Circuit there, of our timely payment requirement. Mountain Solutions, another C Block bidder, came to us requesting a 30-day extension to make its second downpayment. Again, we said we are going to enforce our rules as they are written, waiver request denied. Mountain Solutions went to the D.C. Circuit, attempting to overturn our decision. The D.C. Circuit upheld it in a decision that, like the 2nd Circuit's recent decision, recognizes that we are primarily acting as a regulator, and that by insisting on full and timely payment, we are fulfilling our regulatory goals of getting licenses into the hands of people who will use them most efficiently.

In our view, those decisions are right. If you consider any amendments to the Bankruptcy Code, in our view, you should codify those decisions and not overturn them, as others have asked you to do.

And of course we would be happy to work with your staff if in fact you would like to make any such amendment.

Thank you again.

[The prepared statement of Mr. Wright follows:]

PREPARED STATEMENT OF CHRISTOPHER J. WRIGHT, GENERAL COUNSEL, FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, DC

Thank you for the opportunity to testify.

As you know, the FCC is involved in a number of bankruptcy proceedings involving companies that bid for "C block" licenses to provide wireless telecommunications service. The licenses were awarded by the FCC by means of auctions, and the licenses state plainly on their face that they cancel automatically if payment is not made in full and on time. The key issue in those cases is whether the FCC is properly viewed as a "creditor" or a "regulator." The C block licensees have argued that the FCC is properly viewed as merely another creditor. Accordingly, they have asked bankruptcy courts to permit them to retain their licenses at amounts less than they bid and even though they failed to make payments that were due. We were, of course, very pleased that the Second Circuit, the only court of appeals to have addressed the issue, recently ruled very forcefully that we are properly viewed as a regulator, and held that the bankruptcy court lacked authority to permit NextWave to retain its licenses without satisfying the full and timely payment requirements. *FCC* v. *NextWave Personal Communications, Inc.*, 200 F.3d 43 (2d Cir. 1999).

We understand the focus of this hearing to be on Section 362(b)(4) of the Bankruptcy Code, 11 U.S.C. 362(b)(4). By its terms, that provision states that the automatic stay does not apply to actions enforcing an agency's "regulatory power." NextWave has argued that Section 362(b)(4) does not mean what it says and that Section 362 should be construed to stay enforcement of the FCC's auction rules. That issue is pending before the Second Circuit, and we expect a decision very soon. I am not here today to argue that pending case, but I am happy to explain why, as a matter of policy, it is sensible to conclude that bankruptcy courts should not be permitted to rewrite or stay the effectiveness of our auction rules. If wireless companies can tie their licenses up in bankruptcy proceedings, it will only delay the creation of additional competition that will benefit all Americans.

The FCC was created in 1934, and since that time one of our two core missions has been to manage the radio spectrum. (The other core mission is the regulation of companies that were regarded as natural monopolies, such as wireline telephone companies and cable operators.) With respect to the spectrum, we are the successor to the Federal Radio Commission, which was created in 1927. The basic problem is this: If two people try to use the same frequency at the same time, neither will be heard clearly on account of the resulting interference. To solve that problem, we award licenses granting companies the exclusive right to use a particular frequency in a particular geographic area. So, for example, radio station WETA has the exclusive right in the Washington area to broadcast on 90.9 FM. Anyone else attempting to use that frequency is viewed by us as a "pirate," and if necessary—and it frequently has been necessary in the last few years—we take action to shut down such pirates. The general point is that one of our core missions is to allocate blocks of spectrum to different uses, to distribute licenses within those blocks, and to police the spectrum to make sure that particular frequencies are being used in accordance with our rules and the terms of our licenses.

I am sure you are aware that a wireless telephone is a radio. If you make a call using a wireless phone, it sends your signal to an antenna that then connects your call to the wireline network. A wireless operator has a license issued by the FCC granting it the exclusive right to use particular frequencies in a particular geographic area, just like radio stations and television stations.

The FCC has relied primarily on three methods over our history to distribute licenses: comparative hearings, lotteries, and auctions. In comparing the relative merits of these three methods, one criterion that is of great importance to us is speed in getting spectrum into service. It is second nature to FCC lawyers that warehousing spectrum—or spectrum lying fallow, as we sometimes put it—is a *tragedy*. We want more voices and more competition, wherever possible, and there is a great demand for spectrum. We have allocated more spectrum to wireless telecommunications services over the last decade, so that there are now four or five wireless providers competing in every market. That has led to a dramatic drop in the price to consumers of wireless service along with improvements in the quality of service. We want even more competition, and are very frustrated that much of the C block has not been put to use. We also have allocated spectrum to create a new digital television service, and we going to auction the spectrum devoted to analog television stations in the range comprising channels 60 to 69 in a few months. One problem there is that the new licensees will have to coexist with some of the incumbents until the transition from analog to digital television is completed. It is extremely frustrating that the C block spectrum has been lying fallow while the spectrum devoted to channels 60 to 69 will have to accommodate multiple users for a period of time. We anticipate that some of the winners of the licenses for the spectrum currently allocated to channels 60 to 69 will use the licenses to provide wireless internet service, and many companies are requesting that we clear additional spectrum so that it can be used to provide wireless internet service. Again, it is frustrating that some extremely valuable spectrum has been tied up in bankruptcy proceedings while so many companies are anxious to use spectrum for high speed internet access and we are having trouble clearing spectrum for that use.

Let me turn to a brief description of our three primary methods of distributing licenses. Most licenses to operate radio and television stations were awarded by means of comparative hearings. Under the comparative hearing regime, the Commission would decide which applicant should get a license using a variety of criteria that changed over the years but focused primarily on ability to serve the local community and on the goal of increasing the number of voices providing service to that community. It typically took a long time to conduct a comparative hearing, it has never been possible to develop criteria that identify the best applicant beyond any dispute, and, in part for that reason, extended litigation often ensued after we awarded a license by means of a comparative hearing.

Lotteries have also been used to distribute some types of licenses. Unfortunately, in some cases they have proved to be even slower than comparative hearings as "application mills" were created and seemingly endless litigation ensued over whether lottery winners had the basic qualifications necessary to provide service. Although lotteries are appropriate in some circumstances, they are not as good as auctions in other circumstances in getting licenses into the hands of those best equipped to use them efficiently to provide service to the public.

The FCC obtained auction authority in 1993 and held the world's first spectrum license auction in 1994. The vast majority of our auctions have been great successes in terms of the criteria by which we judge them: getting spectrum licenses quickly into the hands of companies that will use them most efficiently to provide service to the public. The A and B blocks, for example, added two new competitors to the wireless marketplace, replacing the cellular duopoly with real competition that, as I have said, has led to lower prices and better service.

The point I want to emphasize today is that we view auctions primarily as an alternative method of distributing spectrum licenses. In cases involving the distribution of licenses to provide commercial service, we think auctions are preferable to comparative hearings or lotteries. An auction provides a market test of who values the license most highly and, therefore, is most likely to put the license into service most efficiently. An auction is better than a comparative hearing, in our view, in determining who is best equipped to put the spectrum to efficient use—and one might think that we would over-estimate our ability to select the best applicant by comparative means. An auction is obviously preferable to a lottery in that critical respect. And an auction creates all the right incentives to put spectrum into use quickly. If you have paid a large sum for a spectrum license, you are likely to be very eager to put it into service as promptly as possible. You are extremely unlikely to warehouse the spectrum. Again, the A and B block auctions show how effectively auctions can get spectrum licenses into use quickly.

Let me add that auctions are not always the preferable method of distributing licenses. Congress has prohibited us from auctioning licenses to provide noncommercial educational radio or television service, and sensibly so. An auction is not a particularly good method to determine who will provide the best noncommercial service. Similarly, Congress has wisely directed us not to take auction revenues into account when deciding how to allocate spectrum. Allocation is the step prior to licensing where we determine how a band of spectrum may be used; for example, whether it should be used to provide commercial television service or some other service. Obviously, uses such as noncommercial television or public safety would get short shrift if our allocation decisions were governed by financial considerations. Just as obviously, I think, some spectrum should be allocated for the exclusive use of fire and police departments, even if they would not be able to bid as much as AT&T or Bell Atlantic for that spectrum.

The Second Circuit correctly understood that the bankruptcy court had erred by failing to appreciate that the FCC is not a mere creditor. The promise to pay the amount bid at auction on the terms set by the Commission has independent regulatory significance. Our method of distributing licenses obviously is premised on the ability to pay what you bid: willingness to *bid* a large amount, even though you cannot pay it, does not identify an applicant as the person best able to put the spectrum to productive use. In addition, in every auction the winning bidder outbids someone else, and it undermines the integrity of the auction process if a high bidder that cannot pay what it bid according to the terms set nevertheless retains the license. For that reason, every Personal Communications Service license won at auction, for which installment payments were available as an option, plainly stated that it canceled automatically if payments were not made in full and on time. If a bankruptcy court rewrites the amount owed or the terms of payment, it interferes with our core regulatory function. As the Second Circuit stated—the FCC made—full and timely payment of the winning bid—a regulatory condition for obtaining and retaining a spectrum license." *NextWave*, 200 F.3d at 52, quoting 47 C.F.R. 24.708. That court correctly held that "the bankruptcy court had no authority—to interfere with the FCC's system for allocating spectrum licenses." *Id.* at 46.

In addition to the Second Circuit, the D.C. Circuit has recognized the crucial regulatory significance of paying what you bid on time. In the *Mountain Solutions* case, also arising from the C block auction, we refused to grant a waiver to Mountain Solutions, which needed 30 extra days to make its second down payment. The court quoted the Commission's rationale for denying the waiver request and held that it was a sufficient basis on which to deny the waiver request. That rationale was that the "integrity and functioning of the auction process is dependent on having payment obligations on winning bids promptly met. Timeliness of such payments is a necessary indication to the Commission that the winning bidder is financially able to meet its obligations on the license and intends to use the license for the provision of services to the public." *Mountain Solutions, Ltd.* v. *FCC*, 197 F.3d 512, 517 (D.C. Cir. 1999). In addition, the D.C. Circuit stated that the FCC "reasonably focused on the importance of meeting payment deadlines to deter [winning C block bidders] from abusing the lenient [installment payment] structure by shopping a winning bid in order to obtain financing for a payment." *Id.* at 518. In other words, our full and timely payment requirements have critical regulatory significance.

To put this issue into proper perspective, consider a case involving the holder of an FCC license to provide noncommercial radio service. Suppose that licensee went to a bankruptcy court and presented a plan of reorganization that required the bankruptcy court to order us not to enforce the requirement that the company provide noncommercial service. Suppose further that the only realistic way that the company could reorganize would be to obtain revenues from selling commercials. I hope it is as obvious to you as it is to me that the bankruptcy court would be going far beyond its appropriate role, and intruding unreasonably into the FCC's role, if it approved such a plan of reorganization. Plainly, it is for the FCC, and not bankruptcy courts, to determine how many commercial and noncommercial stations are appropriate. If you understand that auctions are an alternative means of distributing licenses, you will understand that the Second Circuit correctly held that the bankruptcy court may not decide who holds FCC licenses by enjoining enforcement of our auction rules.

Or consider the case of a radio station that loses its license at the end of its term after the Commission determines that it is not entitled to renewal under Section 309(k) of the Communications Act, 47 U.S.C. 309(k). Suppose the radio station files a bankruptcy case and argues that it must be permitted to retain its license lest it be forced to liquidate. Again, I hope it is obvious that bankruptcy courts should not be permitted to review our renewal decisions, but that any challenge to a renewal decision must be brought in a court of appeals. Yet under the position advanced by the C block companies in the pending litigation, and contrary to the holding of the Second Circuit, bankruptcy courts would have the power to overturn our renewal decisions.

The Second Circuit also recognized, and we do not dispute, that there may be situations in which we are properly viewed as a creditor rather than as a regulator. 200 F.3d at 59 n.15. Our rules provide that if you do not pay what you bid on time, you lose your license. The Second Circuit suggested that if we pursued a deficiency judgment following such a default, we might properly be viewed as a creditor. In other words, where we are seeking to collect money from the estate, we may be a creditor. But where the question is who holds spectrum licenses, we are properly viewed as a regulator.

In our view, the Second Circuit has properly harmonized bankruptcy law and communications law. The D.C. Circuit likewise has recognized the importance to the integrity of the auction process of enforcement of our auction rules, and particularly our timely payment requirements. If you amend the Bankruptcy Code, you should codify their decisions. You certainly should not overturn them. As the Second Circuit held, allowing bankruptcy courts to ignore or rewrite our auction rules would "interfere with the FCC's system for allocating spectrum licenses." 200 F.3d at 46. For the reasons stated by the court, under the law as it is now written "bankruptcy court[s] ha[ve] no authority" to do so. *Id.* For the reasons I have given, bankruptcy courts should not be given the authority to interfere with our system of distributing spectrum licenses. We would welcome the opportunity to work with your staff to fashion appropriate language.

Thank you again for the opportunity to testify.

Mr. GEKAS. We thank the gentleman.

Before we pose a few questions to our witnesses, let the record indicate that the gentleman from Michigan, Mr. Conyers, the ranking member of the Judiciary Committee, is present. And we accord to him now, if he wishes to do so, to give an opening statement.

Mr. CONYERS. Thank you, Chairman Gekas. I was on the floor on the Asset forfeiture bill that just passed. And I wanted to begin by thanking you and ranking member Nadler for coming to an agreement on these hearings about the automatic stay provisions and what they mean and what the FCC's role in them should be.

I have been increasingly concerned regarding this issue and of our committee's jurisdiction, because the language authorizing actions by FCC to unilaterally cancel spectrum license has been proposed in recent appropriation conferences and even passed the Senate.

This matter has taken on a renewed importance because of the FCC retroactively terminating Nextwave's telecommunications licenses during the course of bankruptcy proceedings. So, the questions that can be addressed during today's hearings—and I have listened to Mr. Wright, and I will read Mr. Posner's contribution here today—is one about the ambiguity of the law. And what direction, if legislation is needed, should it go? And I want to just put in a small flag on behalf of the debtors, because it is a good policy generally to give debtor companies automatic stays so that assets and jobs can be preserved.

However, I come to the hearing and am interested in learning of any countervailing considerations that could be offered by Mr. Wright. And then, of course, I am not sure if this language shouldn't be written by this subcommittee rather than the Appropriations Committee if there is clarifying language needed. Any language that would amend the bankruptcy laws and not communications laws seems to be an important part of bankruptcy jurisdiction.

And in that sense, I agree with both the subcommittee chairman and the ranking member that this is a matter that hopefully can be resolved within the jurisdiction of the Committee on Judiciary. And I thank you for allowing me to make those comments.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF HON. JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

I would like to thank Mr. Gekas for holding this hearing on limits on regulatory power under the bankruptcy code. I wrote him on March 99 2000 asking for this hearing and I appreciate his prompt action.

The automatic stay provisions under II U.S.C. 362 constitute one of the most basic rights available under our bankruptcy laws, and are designed to grant debtor businesses "breathing room" to reorganize their affairs and to preserve jobs. While Congress has chosen to enact a small number of exceptions to the automatic stay provisions, the exceptions are all extremely narrow (such as allowing the government to take certain actions under its "police" authority as necessary to preserve or promote public health or safety). If Federal agencies are able to unilaterally interpret the law as applicable to debtors to take foreclosure type actions without court review, bankruptcy experts have argued this could allow agencies to achieve by regulation what Congress has specifically chosen to prohibit by statute.

I have grown increasingly concerned regarding this issue-and our committee's jurisdiction—because the language authorizing actions by the Federal Communications Commission to unilaterally cancel spectrum licenses has been proposed in recent appropriations conferences and even passed the Senate law year. This matter has taken on renewed importance because of recent actions by the Federal Communications Commission retroactively terminating Next Wave's telecommunications licenses during the course of its bankruptcy proceedings.

There are three questions that I hope can be addressed during today's hearing. First, is there a problem with current law? That is, is the law ambiguous or uncertain? Section 362(b)(4) of the bankruptcy code states that the automatic stay does not apply of "the commencement or continuation of an action or proceeding by a governmental unit or organization . . . to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment. . . ."

Second, if legislation is needed, then in what direction? I begin with a bias in favor of debtors. I generally believe that it is good policy to give debtor companies automatic stays so that assets and jobs can be preserved. However, I come to this hearing with an open mind and am interested in learning of any countervailing considerations by the FCC.

Finally, if legislation is needed who should write it? Certainly not the Appropriations Committee which has hastily put together language in the past. I also strongly believe any language should amend the bankruptcy laws and not the communications law as has been recently proposed. The automatic stay is a critical component of our bankruptcy jurisdiction.

I look forward to today's testimony.

Mr. GEKAS. Yes, we thank the gentleman, and we will begin the questioning by having the Chair yield to itself five minutes for the purpose of examining the witnesses.

The gentleman from Michigan used a word, I think, that is appropriate in relation to some of the questions that I want to ask. That word is ambiguity. The license, any license to me is, as I learned in law school, like an inchoate valuable asset, but it may not have an attendant immediate value. Both of you maintain that here in the exercise of the authority by the regulatory agency, the license is merely a procedural matter, it doesn't have a value, or isn't subject to being collected like money.

Is that a fair, simply groundwork statement to begin the discussion? Aren't you both saying that this is purely a regulatory process function that is being propelled by the administrative agency, and it has nothing to do with collecting monies, and therefore is not subject to the automatic stay. Isn't that what you are saying?

Mr. WRIGHT. The case law distinguishes between regulatory and pecuniary interests. We would acknowledge that the bankruptcy stay would apply if we had solely a pecuniary interest, and that's the way the cases have discussed it. We are now using a market test to determine who is best able to use those licenses. As I said, in the past, we would use a comparative hearing to try to decide who would best use the licenses. We are happy to use the market test. Of course, part of a market test is you have to be able to pay for the license.

Mr. GEKAS. Yes, but in seizing back the license power, or the license in question, aren't you collecting monies that are due even though this is one step removed from putting it out for bid, for instance, or auction? And aren't you just one step away from doing collection work for the agency?

Mr. WRIGHT. I think an important step, and I think the 2nd Circuit recognized that in footnote 15 of its opinion, a very important footnote. There it distinguished the situation for it where we were trying to determine who should have the license and concluded that that is clearly a regulatory function.

Now, it is possible that in certain circumstances we, the FCC, could be going to the bankruptcy court to try to collect money. And the 2nd Circuit said in that circumstance it might well think that we were properly viewed as a creditor. But it seems to us that that is where the line is; that in trying to determine who holds our licenses, we are acting as a regulator. It may well be that if were actually trying to force pavement we should properly be viewed as creditor.

Mr. GEKAS. And, thus, is the ambiguity about which we speak. But I think Mr. Posner suggested that—or Mr. Wright, or both—that if we acted on this that we should be codifying that version of the issue that you have articulated rather than persuade ourselves away from that.

Mr. Posner?

Mr. POSNER. Well, Mr. Chairman, I think, in our view, I think I mention what our view is on amending the provisions to narrow or restrict. We believe that the code currently strikes the appropriate balance; that is, it draws the line in the way Mr. Wright described, that the regulatory agency can't actually enforce a money judgment; it can't pursue a collection action, but it can take, as long as its acting in its regulatory capacity, it can take steps up to that line. We believe that is what the code requires, and we believe that is the way the courts have interpreted appropriately. So, we believe that the code, as presently constituted, draws that balance appropriately.

Mr. GEKAS. Then you don't need action by anybody to sustain your view. The current law, the current code, the current sets of facts, the current court decisions, all substantiate what you are asserting here—that you don't need any codification or revision of any language. Isn't that correct?

Mr. POSNER. Mr. Chairman, I would not go that far. Obviously, the Department has not seen any particular provision, and it is often the case that clarifying legislation is appropriate and needed. We would obviously have to see the proposal, but it might very well be that the Department would strongly support that kind of clarification.

Mr. GEKAS. The time of the Chair has expired. Let the record indicate that the gentleman from South Carolina, Mr. Graham, has now appeared in the committee, as well as Mr. Chabot, the gentleman from Ohio.

The gentleman from New York is now yielded five minutes.

Mr. NADLER. Thank you. Let me start by saying—and maybe it is off the topic—that I am less than thrilled, to put it mildly, to hear that the Agency regards auctions as the best way to exercise its regulatory power and has abandoned all public interest considerations, such as diversity of voices, diversity of views, diversity of programming; that the way to best determine the public interest and who will best use the spectrum is who can pay the most for it. But that is a different question.

Even within that unfortunate decision, let me—within that decision, let me ask the following: Nextwave was given this auction. They bid the highest, I presume. It was given that slice was Spectrum. They didn't make a payment, go into bankruptcy. You then say that in your regulatory function, not as a means of collection, you are going to take the license away from them. They then offer the money, and you say, oh, no. But they now have the money. So, how do you then determine that as a regulatory matter they are not able to use this. Obviously, they bid it; they can now give the money. Isn't this just a transparent attempt to collect more money?

Mr. WRIGHT. No, Congressman.

Mr. NADLER. Why not?

Mr. WRIGHT. It is a matter of fairness, enforcing our rules the way we enforced it against Southeast Telephone and Mountain Solutions. As I stated, Southeast Telephone was precisely comparable to Nextwave. It came to us, it sought a waiver, we said, no, we are going to enforce the rules as they are written, no waiver. We were sustained in the courts by declining to give them a waiver.

Mountain Solutions similarly missed its second downpayment, said it needed 30 days, it could pay in 30 days. We said, no. It is very important to us to enforce our rules as— —

Mr. NADLER. Excuse me. Aren't these all actions to collect debts? Every single thing you just mentioned is an action to collect debt, which seems not to involve considerations to the public health and welfare, which all the cases that you cited in the testimony as exceptions under, what is it, 362(b)(4). Everything your are talking about now has nothing to do with the public health and welfare. It has to do with collecting every last nickel.

Mr. WRIGHT. In neither Southeast Telephone nor Mountain Solutions did we collect any more money from either of those parties.

Mr. NADLER. So, they are unsuccessful attempts

Mr. WRIGHT. We weren't trying to. We took their licenses back and reauctioned them.

Mr. NADLER. But how did that affect the public health and welfare. You were simply punishing them for not giving you money.

How does this differ from exercising a security interest, which you can't do under the bankruptcy laws? You seem to be functioning exactly as if that is what you were doing.

Mr. WRIGHT. Mr. Posner's testimony is more complete than ours given their broader jurisdiction, but they cited many cases that state that the statute should be interpreted to mean what it says. And what it says is "regulatory power," not "health and safety power," and there are many cases that say that the statute means what it says and extends to regulatory power, and so I have simply been trying to make the point that we were exercising our regulatory power.

Mr. NADLER. Mr. Wright, the section, the 362(b)(4) exemption to the automatic stay provision, as amended two years ago, was narrowly drawn to apply the specific circumstances and was not to recovery for pecuniary interests and money judgments. This history of the automatic stay provision exemption explains that these exemptions ought to be given a narrow construction and are intended to prevent or stop violations of fraud, environmental protection, consumer protection, safety, or similar police and regulatory laws.

For example, House Rep Mr. Gilman, who managed that on the floor said that the police and regulatory power is a term which cannot be given the expansive construction for purposes of interpreting the new Bankruptcy Code language. Representative Edwards and DeCochini said it must be given a narrow construction and not apply to actions by government meant to protect a pecuniary interest in property of the debtor or property of the estate. Please tell me how these actions show health, safety, environmental and police powers? How were they involved in the revocation of a debtor's license in bankruptcy other than—well, how were they involved, and how were the not simply protection of pecuniary interests to the State? Then I have one more question.

Mr. GEKAS. The time of the gentleman has expired.

Mr. NADLER. I would ask unanimous consent——

Mr. GEKAS. Another minute.

Mr. NADLER. Thank you.

Mr. WRIGHT. That list also included regulatory powers. That is what we claim we are doing here. I think in my testimony I had an example that is directly on point, both to this and your prior statement. We don't award non-commercial television licenses by auction. We don't think auctions are a very good way to distribute non-commercial television licenses. Suppose a holder of one of those licenses went to a bankruptcy court, and said, "We want you to drop that non-commercial restriction. The only way we can reorganize is to provide commercial television."

Mr. NADLER. That is clearly regulatory.

Let me ask you the following——

Mr. WRIGHT. If you understand the——

Mr. NADLER. Excuse me, sir, let me—I have very limited time; let me ask you the question. Please comment on the proposition that broadcast licenses are not the property of the estate in bankruptcy. Licenses have always been held to be the property of the estate, and I would ask why is this license different from all other licenses?

And I would also like you to explore the broader implications of this case: What incentive do investors have to put up funds for this sort of enterprise if there is no possibility of reorganization, if the major asset of the enterprise is not considered property of the estate and the Agency can cancel the license. Would a reorganization ever be feasible in a broadcast licensee case? Would a debtor in possession financing ever be available?

Mr. WRIGHT. They would have every incentive to do what the A and B Block bidders did—pay in full and on time and get the spectrum into use.

Mr. NADLER. In other words, there can never be a reorganization.

Mr. WRIGHT. That is the incentive. We——

Mr. NADLER. No, no, that wasn't the question. What incentive do they have—would a reorganization ever be feasible in a broadcast licensee case? Because what you seem to be saying is if anybody misses a payment, you seize the license under your regulatory power, and there cannot be a reorganization. So, in effect, tell me why I am wrong to conclude that in a broadcast licensee case, if you get away with this you have abolished the possibility of reorganization, and there is no more bankruptcy possibility ever. Why am I wrong in that conclusion?

Mr. WRIGHT. We have acknowledged that section 108 of the code may give parties 60 days to delay payments, but, yes, beyond that, our position is that you must pay in full and on time.

Mr. NADLER. So, to restate it, your position is that beyond a 60-day delay, a broadcast licensee can never have access to the Bankruptcy Code.

Mr. WRIGHT. No, that is not our position. Our position is—and, of course, television——

Mr. NADLER. They can never successfully reorganize.

Mr. WRIGHT. They have to meet their fulfillment to pay in full and on time.

Mr. NADLER. You said that already. But they can never successfully reorganize. By definition, someone who wants to reorganize is someone who can't meet their payments initially. So, someone who can't meet every payment on time can never reorganize. Is that the implication of what you are saying?

Mr. WRIGHT. Television stations go into bankruptcy all the time and use their licenses as collateral to reorganize.

Mr. NADLER. But you said that licenses aren't property of the estate, so how they can use the license as collateral?

Mr. WRIGHT. We did not say that licenses are not property of the estate. We haven't found it necessary to reach that issue.

Mr. GEKAS. The time of the gentleman has expired.

The gentleman from South Carolina, Mr. Graham, is granted five minutes.

Mr. GRAHAM. Would the gentleman from New York like—Mr. Nadler, would you like to finish your thought?

Mr. NADLER. Yes, thank you. I appreciate it.

Mr. GEKAS. Charged against the South Carolina time.

Mr. GRAHAM. Yes, I will yield.

Mr. NADLER. I just must express astonishment. If you have not said that the license is not the property of the estate—you must say that, because otherwise how can you seize it? If it is the property of the estate, it is subject to the stay in bankruptcy, and the position you have taken seems to be—can only be that the license is not the property of the estate. It is yours to regulate, to seize back if every payment is not met, and nobody with a license, other than possibly a commercial license, can reorganize unless they have met every payment in which case they wouldn't have to reorganize.

Mr. WRIGHT. Well, we should send you our brief in the pending case, but whether or not licenses are property of the estate, the stay does not apply pursuant to 362(b)(4) construed in accordance with what it says.

Mr. NADLER. I yield back. Thank you.

Mr. GRAHAM. Thank you very much.

I want to—the reason I yielded is because we seldom agree, but we are agreeing today, so I want to save this magic moment here. [Laughter.]

Mr. NADLER. Mr. Graham, Mr. Hutchinson and I just held a press conference introducing a bill together, so maybe the millennium has arrived.

Mr. GRAHAM. Oh. [Laughter.]

Maybe the end of the world's coming; who knows what is happening.

But, anyway, this big theme of why do you come to Congress and ask us to give you an exemption if you don't need an exemption? I know that has been asked, but I want to ask it again. Why did your chairman, Chairman Kenard—go to the Senate Subcommittee on Commerce, Justice and State to ask that subcommittee consider language to exempt the FCC from operation of the automatic stay if the law says you are not part of the automatic stay to begin with? What is going on here?

Mr. WRIGHT. We wanted to prevent the two and a half year delay that we have suffered. We always thought this was clarifying regulation. We always thought there was a good chance that a bankruptcy court might harmonize communication law and bankruptcy law in a way that, from our perspective, unduly emphasized bankruptcy law. We always expected that the court of appeals would uphold our view, but that it would take two and a half years.

Mr. GRAHAM. Well, let me tell you, if I was a judge, I would throw you out on your ear if you came to me and you said the reason that I am exempt from bankruptcy stays is because of regulatory powers. What they mean there, and I think the common sense definition is, if you are in the hazardous waste business and you declare bankruptcy and it is a threat to the public, they are not going to give you a stay and let you keep operating. They are going to shut you down.

If you are throwing pollutants out into the air, they are going to shut you down and not let bankruptcy control the public health. What you are trying to do here is say that because you regulate that you are no longer subject to the pecuniary situation where you find yourself as a creditor. Who in the world would lend money to a radio or TV station that bought some spectrum at the auction if you could come in there at any moment and just take the thing over?

Mr. WRIGHT. I am glad we had the panel, the 2nd Circuit panel that we had, which unanimously viewed the law the way we see it.

Mr. GRAHAM. Well, here is what I am saying: I am saying that in the economics of this—the government leases mineral rights all the time. If the government can just pull that lease at any time and jump ahead of every creditor in the world, who is going to lend money to these people wanting to explore mineral rights if your definition of regulatory, in terms of bankruptcy, prevails, that nobody who deals with the government is ever going to be able to get private sector creditors to help their business, because you, on a whim, because of your definition, can basically shut down that business and leave everybody holding the bag. That is the consequence of what you are arguing here, and that is a devastating consequence to the economy, and I think the case law is pretty clear here. And let me see if you agree with some quotes from the judge in the 2nd Circuit.

Are you familiar with Judge Hardin?

Mr. WRIGHT. He is not on the 2nd Circuit.

Mr. GRAHAM. I know.

Mr. WRIGHT. He is the bankruptcy judge who ruled against us——

Mr. GRAHAM. Do you know who he is?

Mr. WRIGHT. [continuing]. Whose decision was overturned by the 2nd Circuit.

Mr. GRAHAM. And you are saying that when he says there is no dispute that the bankruptcy's automatic stay applies to the Federal Government's agencies, such as the IRS and FCC, that he has no basis for saying that.

Mr. WRIGHT. The 2nd Circuit agreed with our view.

Mr. GRAHAM. Okay. And who reviews the 2nd Circuit?

Mr. WRIGHT. The Supreme Court.

Mr. GRAHAM. The Supreme Court.

You come to Congress asking us to basically give you an exemption that no other Federal agency has. Why do you need it?

Mr. WRIGHT. Again, we won in the 2nd Circuit because we already have this exemption.

Mr. GRAHAM. Why shouldn't we give this to the IRS?

Mr. WRIGHT. Mr. Posner is better able than I to discuss other Federal agencies.

Mr. GRAHAM. Does any other agency have this exemption in Federal law that you have been requesting?

Mr. POSNER. Congressman Graham, what exemption are you referring to?

Mr. GRAHAM. Well, they have come to Congress and asking us to exempt them from the automatic stay provision, the FCC, in situations of collecting money.

Mr. POSNER. I don't know the answer to your question. We will endeavor to respond to your question.

There was an issue, I think, that Congressman Nadler raised before that I think is important to emphasize here that I don't think has been emphasized, and that is that what the 2nd Circuit—central to the 2nd Circuit's ruling was that regulatory interests like the FCC's Radio and Spectrum Program serve the public interest just as public safety and health and welfare; that those are elevated to the same respect and importance, and that Congress has already made the determination in setting up the licensing. That's a critical program that serves the public interest.

Mr. GRAHAM. Every agency in this Government has some regulatory authority, and I find it unacceptable to hold that when there is money transactions involving the Federal Government and the private sector, the Federal Government positions itself in a fashion that you are wanting us to do.

The Nextwave situation. During bankruptcy, during the stay proceedings, they didn't make their payment, and based on that failure to pay during the bankruptcy period, you withdrew their license, right? The creditor that these people had is holding the bag. How are we ever going to get anybody to finance companies that find themselves in the position of Nextwave, if we allow you to destroy the bankruptcy stay provisions because you can regulate in general? You can take this to the area of mineral rights. There is a thousand different financial situations going on between private enterprise and the Federal Government daily, and if we do what you want us to do, we are basically going to destroy the ability of these companies or people to get loans. Do you disagree with that?

Mr. WRIGHT. Well, we don't necessarily want you to do anything, and the way we have responded to the bankruptcy court——

Mr. GRAHAM. Well, now, wait a minute. You came here March 21 over at the Senate saying you wanted an exemption. Do you want us to do something or not?

Mr. WRIGHT. We think that that would be a helpful clarification. We have responded to the bankruptcy court decisions by discontinuing installment payment auctions. So, at least, from our perspective, this is a sort of a confined number of cases that are unlikely to arise again, although I appreciate from the broader Government perspective they might.

Mr. GRAHAM. That it would create chaos. Thank you.

Mr. GEKAS. The time of the gentleman has expired.

The gentleman from Michigan is recognized for five minutes.

Mr. CONYERS. Thank you very much, Mr. Chairman.

I suppose one of the things disturbing us is the fact you went over to the Senate in the first place. I mean here Committees on Bankruptcy operating, and in another process, with another committee you had language inserted that was ultimately knocked out in conference.

Couldn't you have started off with—FCC started off by coming to a Bankruptcy Committee to address this concern?

Mr. WRIGHT. I have been informed that we did that in 1997, but the clarifying legislation that would have prevented this warehousing of the C Block spectrum was presented to a number of committees three years ago.

Mr. CONYERS. So, then you sought another route. You see, the—let us get back to kind of an elementary jurisdiction thing. All a number of members of this subcommittee are asserting is that these matters should be finalized and resolved through the committee that is set up to handle a rather complex part of our law—bankruptcy law. Now, maybe you didn't like the disposition or the way it was resolved, and then I suppose you might say, "Well, then we didn't have any other choice, that to achieve our end we had to go somewhere else, Congressman, and we did."

But what we are concerned about is what the effect of this provision would mean in bankruptcy and how it would effect a lot of other people, some of them even not in bankruptcy. Because these legislative changes are, first, pretty drastic, and second, they may go beyond what we really thought the law was all the time. And, so we are glad you are here today, but we are going to be watching what happens in the court, because it may be necessary for the committee to assert new language depending on the decision. I have no idea what they are thinking about or what their attitude has been toward this or other related matters.

But in this one instance, your chairman, who is a dear friend of mine, may have been off on the wrong track. This matter should either be left to the tender mercies of the court, and then the Bankruptcy Committees of jurisdiction will determine what they will do rather than these sidebar excursions through appropriations or some other committee. And, so it is in that spirit that we approach this matter.

Some believe that there are two—the FCC has two roles, and in a way they may be getting their roles confused, because by holding the license and not allowing it to be reclaimed, you are working an irrevocable harm, and the results are contrary to many of the goals of the bankruptcy proceedings themselves.

Mr. WRIGHT. We will get a decision, I am confident, of the last one from the 2nd Circuit very soon. They ordered us to file a brief on February 22. They ordered Nextwave to file a brief on February 28, as you can see, an extremely condensed briefing schedule. I think everyone expects a decision this month.

Mr. CONYERS. Well——

Mr. GEKAS. The time of the gentleman has expired. Does he wish additional time?

Mr. CONYERS. No, I think I have stated my position here, and I will feel free to stay in touch with the FCC as the case may be required.

Thank you, Mr. Chairman.

Mr. GEKAS. The time of the gentleman has expired.

We turn to the gentleman from Ohio, Mr. Chabot, who is allotted five minutes.

Mr. CHABOT. Thank you, Mr. Chairman.

Since I had another commitment, I was unable to get here in time to hear the testimony of these two witnesses. So, rather than question the witnesses myself, I would be happy to yield the time to the—such time as he might like to consume to the gentleman from South Carolina, Mr. Graham.

Mr. GRAHAM. Well, thank you. I just wanted to follow-up——

Mr. GEKAS. You should have the permission of the Chair for that, but that is all right.

Mr. GRAHAM. This will be short. The Small Business Administration deals with the private sector daily. This is a Government agency; it has regulatory authority. Housing and Urban Development Department deals with the private sector daily. Would it be your position that, because they have regulatory authority, if a situation occurred where bankruptcy happened to one of the people they deal with that they would be able to come in and do what you are suggesting?

Mr. WRIGHT. Well, I think the judicial test is whether they are acting primarily in a regulatory or in a pecuniary role.

Mr. GRAHAM. Well, let us get back to Nextwave. All you did in Nextwave is you took the license back, because they hadn't paid the money.

Mr. WRIGHT. And, again, the whole thrust of what I have tried to explain today is just like a comparative hearing, just like a lottery. An auction is a regulatory means of getting the license.

Mr. GRAHAM. It doesn't matter how the debt came about. The fact is that you took their license, because they didn't pay the debt. HUD, the Small Business Administration finds themselves in situations like this daily. My concern is that if we go the route you want us to, that the private sector is going to be very adversely affected, and if you don't honor these pecuniary relationships in some fair way to the rest of the creditors in the world who deal with these people, that the Government is going to destroy the ability for these people to succeed at small businesses, purchase section 8 housing, or buy spectrum licenses. And I just think it is devastatingly bad for the economy, and if the court goes this way, I would join with my friends on the other side and try to correct it, because I think the regulatory function that you are talking about to prevent you from being in a stay situation does affect the public health, and this is not a situation like that.

Thank you, Mr. Chairman.

Mr. GEKAS. The time of the gentleman has expired.

The gentleman from New York is accorded an additional 30 seconds.

Mr. NADLER. I just want to observe, since I have been, by my tone, I think quite critical of the Agency in this matter, I want to commend, through you, I want to commend the chairman for his attitude in the Low Power matter.

Mr. WRIGHT. I am happy to pass on that favorable comment to our chairman, and Congressman Conyers, your warm regards to Mr. Kennard.

Mr. GEKAS. The time of the gentleman has expired.

The time of this panel has expired. We express our gratitude, and we suspect that by your presence here you would yield to written questions if any of the members wish to pose them. We thank you for that. They both agree, for the record, that they would do that.

We now call the next panel to the witness table.

Douglas Baird is the Harry A. Bigelow distinguished service professor at the University of Chicago Law School where he has taught commercial law and bankruptcy since 1980. Professor Baird has also served as dean of the law school from 1994 to 1999. He has been a visiting professor at Harvard and Stanford Law Schools and, currently, Yale.

Professor Baird has authored numerous law review articles and case books relating to bankruptcy, including "Elements of Bankruptcy," a book explaining the basic principles of bankruptcy law. I think he should give us each a copy of that at his first convenience.

Professor Baird completed his undergraduate studies at Yale College and received his juris doctorate from Stanford Law School. He is also a Fellow of the American Academy of Arts and Sciences and the current Vice Chair of the National Bankruptcy Conference.

Carlos J. Cuevas is a scholar in residence at St. John's University of Law in New York. In addition, he is associated with the law firm of DelBellow, Donalyn, Winegarten, Tartaglia, Weiss, and Widecker in White Plains, New York. Mr. Cuevas is a chapter 7 trustee for the Southern District of New York and serves as a mediator for the U.S. bankruptcy court in that district.

The author of several law review articles, Mr. Cuevas has served as a contributing editor of the American Bankruptcy Institute Journal. Mr. Cuevas is a graduate of New York University and received his law degree from Yale.

Kathryn Heidt is a professor at the University of Pittsburgh Law School and currently a visiting professor at the University of Pennsylvania Law School. Professor Heidt serves as the vice chair of the Business Bankruptcy Committee of the Business Law Section of the American Bar Association. This committee consists of 1,500 bankruptcy attorneys, judges, and professors representing various aspects of the legal profession dealing specifically with business bankruptcy law. It is in that capacity that Professor Heidt has been authorized to present the position of the ABA and its 400,000 members.

They are joined by Louis S. Robin, a partner in the Massachusetts law firm of Fitzgerald, O'Brien, Robin, and Shapiro. He appears today on behalf of the Commercial Law League of America, where he serves on the league's Executive Committee of the Bankruptcy Section of the Commercial Law League of America. Mr. Robin is the author to several publications and a contributing author to Matthew Bender's "Commercial Law and Practice Guide." Additionally, he is the editor of the "Commercial Law Journal."

Previously, Mr. Robin was the law clerk to the Honorable Harold Levian, a United States bankruptcy judge for the District of Massachusetts. Mr. Robin received his B.A. from the State University of New York at Albany and graduated from Fordham University School of Law where he was the editor of the "Fordham Urban Law Journal."

We welcome the panel. We will begin the testimony in the order in which they were introduced.

Mr. NADLER. Mr. Chairman?

Mr. GEKAS. The gentleman from New York wants to do additional commentary in the introduction.

Mr. NADLER. Thank you. First, let me give a special welcome to Mr. Robin, who is an alumnus of the same law school, Fordham Law School. And I want to especially note the presence of Mr. Cuevas, who is a friend of long-standing from New York and the son of the city clerk of New York and the stepbrother of a fellow who succeeded me in the State assembly when I was elected to the House of Representatives.

Mr. CUEVAS. Can you stop there?

Mr. NADLER. That is where I would stop. And I just want to extend a special welcome to Mr. Cuevas.

Mr. CUEVAS. It is my pleasure, Mr. Congressman.

Mr. GEKAS. As indicated before, the written statements will automatically become a part of the record, and we ask, out of courtesy to all assembled, that the oral statements be restricted as much as possible to five minutes. We will begin in the order in which the witnesses were introduced, with Professor Baird.

STATEMENT OF DOUGLAS G. BAIRD, PROFESSOR AND VICE CHAIR, NATIONAL BANKRUPTCY CONFERENCE

Mr. BAIRD. Mr. Chairman, thank you very much.

The problem we have today is relatively simple. In trying to figure out when is an agency acting as a regulator and when is it acting as creditor, a good approximation that the right answer is to ask would the agency be doing what it is doing if it weren't owed any money?

Mr. GEKAS. If what?

Mr. BAIRD. If it were not owed any money. In other words, would the FCC want to take back the license if it weren't owed any money? I think, for example, the concern that was raised in the previous panel about the absence of use of this license for a period of time and what a bad thing that was, I would look at the Gulf Air case. That is exactly what happened in the Gulf Air case. This was a case in which an airline had landing rights. It was in bankruptcy, and it wasn't using the landing rights. And what the court did was say, "Look, you are in bankruptcy, you are out of bankruptcy, you have got to use it or lose it, and we are going to take the license back," and the bankruptcy court and the circuit court said, "That is fine." In other words, as a regulator, the FCC could insist that you use a license, whether you are in bankruptcy or not. What it can't do is say we are going to act as a secured creditor and get our license back if we are not paid.

I would also urge the committee to look at the cases that are being cited here and ask are these cases different from the case where you are trying to collect on a promissory note? For example, the Javins case that is cited on page 6 of the Department of Justice testimony is a situation where what a city wanted to do was demolish a dangerous building. And the question is if there is a dangerous building and the debtor happens to be bankruptcy, does that mean you can't demolish the building? The answer is of course not.

The automatic stay doesn't prevent an agency from doing that. What it does, however, it prevents them from exercising its rights as a creditor unilaterally in a way that imposes forfeitures. When it is acting as a creditor, it has to play by the same rules as everyone else.

What I would add to this is to remind you that to say that the FCC is a creditor in this case is not to say that it is without very significant powers. If, for example, the agency bargained for security interest at the time that it issued the license, if it has the lien that entitles it to the rights of a secured creditor, it is entitled to be paid every dime that it is owed ahead of every other creditor and every shareholder. That is what the absolute priority rule requires.

In addition to that, if it is owed more than its collateral is worth and the debtor is insolvent and an effective reorganization is not in prospect, then under 362(d), it has the right to come into court and ask to have the automatic stay lifted and take its assets back again.

So, when we think about the balance to be struck here and when we say an agency, when it is owed money and trying to get money has to be treated as a creditor, we are not saying that it is powerless. If it has established for itself the rights of a secured creditor, it has very significant powers in bankruptcy, and that is because our bankruptcy laws are wonderfully well crafted, and they do acknowledge that when you lend someone money you should get it back. And I think there is not a dramatic need to reform the law here; that point could be qualified.

But I also think that if you sell someone a license, the idea that that is a property of the estate subject to all of its limitations outside of bankruptcy, the idea that when you are trying to collect on a promissory note you are acting as a creditor rather than a regulator, I think those principles are fairly well established, fairly well supported by the case law.

We don't know what the 2nd Circuit will do. There was dictum that was talked about previously in a fraudulent conveyance case decided in December. It is still going to decide this. I think over time courts can decide these kinds of issues correctly. There may not be a need to have clarifying language, but again if your committee thinks clarifying language is important here, the National Bankruptcy Conference has given you some proposed legislation. We would be happy to help you with respect to the technical issues, if that is the direction you would like to go in.

And, of course, if you would like to go in any other direction, the National Bankruptcy Conference would also be more than happy to provide technical assistance.

[The prepared statement of Mr. Baird follows:]

PREPARED STATEMENT OF DOUGLAS G. BAIRD, PROFESSOR AND VICE CHAIR, NATIONAL BANKRUPTCY CONFERENCE

I am the Harry A. Bigelow Distinguished Service Professor at the University of Chicago Law School. Since 1980, I have taught commercial law and bankruptcy at the University of Chicago, as well as at Harvard, Stanford, and Yale. I also serve as the Vice Chair of the National Bankruptcy Conference, and it is in that capacity that I appear today. The National Bankruptcy Conference is a voluntary nonpartisan organization of judges, academics, and practitioners interested in sound bankruptcy law and policy. For over 70 years, it has assisted Congress in crafting our bankruptcy laws.

The central problem presented by cases like NextWave is a familiar one. The FCC is charged with ensuring that NextWave, like other licensees, complies with the laws and regulations governing the use of the electromagnetic spectrum. At the same time, the FCC holds a promissory note from NextWave for over $4 billion. As a regulator, the FCC is exempt from the automatic stay under § 362(b)(4). Debtors in bankruptcy must conform their conduct to the law just like anyone else. On the other hand, as someone seeking payment on a promissory note, the FCC is a creditor and, as a creditor, it must bide its time and participate in the reorganization process on the same basis as the other creditors.

Our law of corporate reorganizations prevents creditors from trying to assert their individual rights. If it did not, the efforts of each creditor to be paid would threaten to destroy both the firm and the jobs it generates. Bankruptcy law minimizes the costs of financial failure. Such rules are all the more important in path-breaking industries that employ new technologies. Here the potential rewards are high, but the risk of financial failure is great as well.

The problem in *NextWave* arises in many contexts. From landing slots issued by the FAA to liquor permits granted by local governments, an agency must separate its role as regulator from its role as creditor. To comply with the Constitutional mandate that there be "uniform laws on the subject of bankruptcies," Congress must ensure that it does not allow its treatment of the same problem to turn on the agency that is involved. A piecemeal approach undermines both the effectiveness of government regulation and the operation of capital markets.

The following simple case highlights the crucial issues. Town decides to auction off a taxi medallion. To encourage small entrepreneurs, Town agrees to finance much of the purchase price. Firm makes a winning bid of $11,000 for a medallion. Firm uses $1,000 to make the down payment, and promises to pay the balance over a number of years. Firm borrows an additional $10,000 and uses it to buy a used cab. Firm's owner is confident that the taxi can generate enough to pay back Town and the creditors and still leave him with a healthy profit.

There is an economic downturn, however, and the cab service is less popular than expected. As a result, Firm cannot meet its obligations to Town and the other creditors. It files a Chapter 11 petition. Firm is insolvent. It owes $20,000, but the business is worth only $15,000.

The basic principles that should govern this bankruptcy can be stated briefly. Firm must continue to comply with all the rules governing taxis. Town might limit the operation of the cab to 12 hours a day. It might require replacement of any cab that is more than 5 years old. It might require installation of a partition between the front and back seats. Bankruptcy law does not second-guess the wisdom of any of these rules, even when they are so burdensome that they force Firm out of business.

Debtors in bankruptcy have to obey the law. If the debtor's property has been condemned as unsafe, the government can demolish it in bankruptcy just as it can outside. In re Javens, 107 F.3d 359 (6th Cir. 1997). When an agency exercises its regulatory power to ensure the public's health and safety, § 362(b)(4) ensures that its hand remains unfettered. OSHA rules, minimum wage laws, and environmental regulations apply with full force, and bankruptcy judges have no power to interfere with their operation.

But just as we do not exempt debtors from the law while in bankruptcy, we do not penalize them on that account either. Rights should not change merely because of the happenstance of bankruptcy. *Butner* v. *United States*, 440 U.S. 48, 55 (1979). To return to our hypothetical, the taxi medallion is property of the estate under § 541(a). It comes into the estate, however, subject to all its nonbankruptcy limits. *Chicago Board of Trade* v. *Johnson*, 264 U.S. 1 (1924).

A restaurant does not lose its operating permit merely because it has filed for bankruptcy, but health inspectors are free to close it down if it violates municipal sanitation ordinances. Similarly, if FAA regulations condition the ownership of landing slots on their continued use, they are forfeited in bankruptcy if they are not used, as they would be outside. In re Gull Air, Inc., 890 F.2d 1255 (1st Cir. 1989).

Limitations on the transfer of assets are also respected in bankruptcy. If Firm had no ability to sell the medallion outside of bankruptcy, it has no ability to do so inside. See, e.g., In re Tak Communications, Inc., 985 F.2d 916 (7th Cir. 1993). Town, however, cannot provide that the medallion is forfeited in the event of bankruptcy. § 541(c)(1). Such "ipso facto" clauses, if respected, would destroy going-concern value. A taxi cab has little value without the medallion. A television transmitter is worthless without a broadcast license. A commercial jet has value only if it can be flown. Hence, we do not penalize debtors merely because they have filed for bankruptcy.

Bankruptcy respects creditors' rights, but in a way that ensures that the firm survives if (but only if) it is economically viable apart from its problems with its creditors. Shutting down a taxi cab company because its cabs are unsafe is different from shutting it down because doing so allows one creditor to gain an advantage over another. Forfeiture provisions undermine bankruptcy policy. In our hypothetical, Town chose to finance buyers of taxi medallions. Once it does this, Town must live with the consequences. It can continue to regulate taxis as before, but to the extent it tries to collect what it is owed, Town is a creditor.

Town undoubtedly will argue that it should be paid first and the other creditors should come second. Town's priority, however, should have nothing to do with its also being a regulator. Town should enjoy priority only if it bargained for it and complied with nonbankruptcy rules governing the creation of a security interest in personal property. Doing this typically requires a public filing.

If Town took these steps and took an interest in all the assets of Firm, it would be entitled to $10,000 (the amount it is owed). In bankruptcy, we can respect the value of this right by giving Town a lien on the assets of Firm and a note that was worth $10,000. As a fully secured creditor, Town is entitled to the value of the medallion, but not to the medallion itself. Allowing Town to take the license itself would destroy Firm's going-concern value and the jobs it generates.

If Town did not take a security interest, it should be treated as a general creditor. In this event, it should receive a note worth $7,500. The creditors as a group are owed $20,000, and the assets are worth $15,000. Hence, all the creditors receive 75 cents on the dollar. Entrepreneur's equity stake is wiped out. It can remain the owner of the equity only if it contributes new value and shows it is paying top dollar for it. Again, the policy behind preventing the forfeiture is preserving going-concern value and jobs, not protecting the interests of equityholders.

NextWave involves billions of dollars and cutting-edge technology, but the fundamental issues are the same as with the taxicab company. The FCC wears two distinct hats in bankruptcy. First, it acts as a regulator. Ensuring that debtors in bankruptcy remain bound by the rules that govern their on-going operations is one of the most firmly established principles in bankruptcy. See 28 U.S.C. 959(b). All of the FCC's rules governing the uses to which these licenses may be put should apply with full force in bankruptcy. The FCC's ability to do this is the exercise of police and regulatory powers excepted from the automatic stay under § 362 of the Bankruptcy Code.

The FCC, however, also wears the hat of a prepetition creditor. It entered into a transaction with NextWave in which it agreed to issue a license in return for a promissory note. As an entity that is owed a fixed sum, the FCC should participate in the bankruptcy process on the same basis as any other creditor. It should not be able to argue that, because it also acts as a government regulator, it is beyond the jurisdiction of the bankruptcy court when it comes to enforcing a promissory note.

If it failed to obtain a security interest in the license, the FCC might argue that it has effectively a lien on the license that entitles it to be paid at least up to the value of the license. Undisclosed liens, however, have always been suspect under Anglo-American law. The IRS, for example, must make a public filing to acquire a lien senior to those of the taxpayers—secured creditors. See 26 U.S.C. §6323. No policy is served by giving the FCC a priority when it could have, if it made economic sense, bargained for such a priority in the same way as any other creditor.

NextWave suggests that it might make sense to clarify the law on the question of how licenses should be treated in bankruptcy. New legislation could clarify the law to ensure that licenses are treated as "property of the estate" and that a regulator like the FCC enjoys the status of a creditor when it holds the promissory note of one of its licensees. I append sample legislation that would implement these ideas. These principles, however, are well established under current law. Congress might sensibly take the view that no legislation is needed here.

Amendment to Title 11, U.S. Bankruptcy Code

"Sec.________Section 362 of title 11, United States Code, is amended by"

(1) inserting at the end the following new subsection:

"(i) In this section, "police or regulatory power" excludes any act, action, proceeding, rule, regulation, or law that affects property of or from the estate to secure or satisfy, in whole or in part, or based on nonpayment of, in whole or in part, a debt."; and

(2) striking out "and (8)" and inserting the following:

"(8) the application of any law, rule, regulation, or agreement that terminates or revokes or gives a governmental unit the right or option to terminate or revoke a license under which the debtor is the licensee based on the nonpayment in whole or in part of a debt; and (9)".".

This language would clarify existing law to restrict acts, actions, proceedings, rules, regulations, or laws exempted from the automatic stay by new section 362(b)(4) to those that are truly in the exercise of police or regulatory powers. Thus the government could confiscate chemical weapons or shut down a chemical weapons factory. But where the action is taken or a rule, regulation, or law applies to secure or satisfy a debt or affect property based on the nonpayment of a debt, the stay would remain in effect. This amendment excludes governmental functions from the stay, while keeping the stay in effect for proprietary functions and functions that raise revenue.

" 'Sec.________Section 102 of title 11, United States Code, is amended by striking out 'and (9)' " and inserting after paragraph (8) the following new paragraph:

"(9) notwithstanding any other law, rule, or regulation, in this title, including for purposes of sections 541 and 362, property includes the debtor's interest in a license under which the debtor is a licensee as of the date of the filing of the petition; and (10)".".

Mr. GEKAS. We thank the gentleman.

We turn to the next witness, Mr. Cuevas.

STATEMENT OF CARLOS J. CUEVAS, ATTORNEY, SCHOLAR IN RESIDENCE, ST. JOHN'S UNIVERSITY LAW SCHOOL

Mr. CUEVAS. Mr. Chairman, it is a pleasure to be here today.

I just have a very narrow perspective, and that is that I think section 362(b)(4) is an excellent statute that should not be amended. I think what the major discussion has been today is ambiguity regarding the FCC issue, and if this committee thinks that it is necessary to address that issue, that it should be done by particular legislation addressing that discrete issue.

As has been said by Congressman Conyers, (b)(4) is a very narrow but yet important statute, because it protects society from malefactors. And as Congressman Graham and Congressman Nadler have stated, you need to address what occurs when you have a debtor that is violating environmental laws, discrimination laws, and other types of laws that are directed to public health and safety.

By leaving 362(b)(4) alone, you have a substantial body of case law that provides for predictability. As was done with, let us say, technology licensing agreements, you had a specific problem, and you tailored a comprehensive statute to address that particular issue. And here, as you stated, there is ambiguity, and there are issues concerning whether licenses are property of the estate. If you provided specific legislation, then you would also provide financial markets with clarify as to what would occur when you have companies that hold these licenses when they file for bankruptcy. So, therefore, I would state on behalf of St. John's Law School that (b)(4) should be left alone, and if you are going to address this issue, that it should be done by very narrow legislation.

Thank you.

[The prepared statement of Mr. Cuevas follows:]

PREPARED STATEMENT OF CARLOS J. CUEVAS, ATTORNEY, SCHOLAR IN RESIDENCE, ST. JOHN'S UNIVERSITY LAW SCHOOL

I come here today as an academic who has studied the operation of Bankruptcy Code Section 362(b)(4), as an attorney who has represented Chapter 11 debtors, and a Chapter 7 Trustee. Therefore, not only do I have a theoretical understanding of the bankruptcy system, but also a practical understanding of the bankruptcy system. Bankruptcy Code Section 362(b)(4) is an important bankruptcy statute, equally importantly, this statute is important to the safety of our society.

Bankruptcy Code Section 362(b)(4) and Judicial Code Section 959(b)[1] mandate the enforcement of regulatory laws in bankruptcy cases. Judicial Code Section 959(b) requires that a debtor-in-possession adhere to all applicable regulatory laws. In *Gillis v. California*[2], the Supreme Court ruled sixty-five years ago that pursuant to Judicial Code Section 65, the predecessor of Judicial Code Section 959(b), that a receiver had to comply with applicable regulatory laws. Therefore, the enforcement of health and safety laws in insolvency cases is not a novel concept, but rather, it is an established component of the bankruptcy system.

The operation of Bankruptcy Code Section 362(b)(4) is not abhorrent to the operation of the bankruptcy system. The purpose of a corporate reorganization case is to reorganize a debtor's contractual relationships and capital structure, and therefore, make it a viable enterprise. The purpose of a Chapter 7 case is to provide for an efficient and equitable distribution of a debtor's assets. The focus is on the financial viability of a debtor's enterprise. If a debtor is unable to comply with valid government regulation, then the debtor is not a viable enterprise. Usually there has been administrative action prior to the commencement of a bankruptcy case. The filing of a bankruptcy case should not affect the administrative action or litigation. The administrative body or state court is a court of competent jurisdiction. The presumption is that the administrative agency is attempting to protect the well-being of its citizens. The administrative agency has expertise in the particular area, and it is attempting to enforce a complex statutory scheme. The bankruptcy court may lack familiarity with all of the nuances of the complex regulatory scheme that the administrative agency is attempting to enforce. There are compelling public policy reasons that a bankruptcy court should not interfere with regulatory activity.

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[1] The Judicial Code Section 956(b) states:

> Except as provided in § 11666 of title 11, a trustee, receiver or manager appointed in any case pending in any court of the United States, including a debtor-in-possion as such trustee, receiver or manager according to the requirements of the validlaes of the state in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

28 U.S.C. § 959(b)

[2] 293 U.S. 62. (1934)

As a practical matter, there are malefactors that attempt to exploit the bankruptcy process and circumvent legitimate government regulation. Although these malefactors represent a minute percentage of the entities that file for bankruptcy, these malefactors can have a deleterious impact on society. A debtor that operates a residential apartment complex should comply with the applicable building code. However, a local municipality should not be permitted to use Bankruptcy Code Section 362(b)(4) to foreclose its real estate tax lien.

If there is bad faith enforcement, then a debtor has the option of commencing an action in United States District Court under the Younger abstention doctrine to obtain an injunction. In addition, a debtor also may seek an injunction in the United States Bankruptcy Court pursuant to Bankruptcy Code Section 105(a). Therefore, there exists safeguards to protect a debtor from illegitimate administrative enforcement actions.

In conclusion, Bankruptcy Code Section 362(b)(4) performs an important role in the bankruptcy process. Thus, the statute should not be amended.

Mr. GEKAS. We thank you, Mr. Cuevas.

Professor Heidt.

STATEMENT OF KATHRYN HEIDT, PROFESSOR AND VICE CHAIR, BUSINESS BANKRUPTCY COMMITTEE, SECTION ON BUSINESS LAW, AMERICAN BAR ASSOCIATION

Ms. HEIDT. Thank you.

I would like to just begin by saying that I am here on behalf of the American Bar Association, and the American Bar Association has an official position which impacts on not only FCC questions but also some larger questions regarding priority.

First of all, the ABA has passed a resolution, through its House of Delegates, on behalf of its 400,000 members.

There are three things that I would like to say today. First of all, the resolution asks that no bankruptcy legislation be passed without an opportunity for a hearing before this committee.

Mr. GEKAS. What did you say?

Ms. HEIDT. That no bankruptcy legislation be passed without an opportunity for a hearing before this committee. Secondly, that there be no new priorities given, and third, that no legislation should be retroactive.

Now, all of those things play into what we have talked about. Essentially, if you allow the FCC to cancel a license you are giving it a priority. Professor Baird referred to it as the equivalent of a security interest. You could also look at in terms of a priority.

The ABA passed a resolution. The first part, in terms of opportunity for a hearing before this and the appropriate committees, is about process. The second part is about no new priorities and is substantive. The ABA is against, and has a blanket authority rule against, granting any new priorities absent some very compelling circumstances.

If we look at the reasons for this resolution, we see that in a chapter 7 the idea is primarily to gather all of the assets together and distribute them fairly. If we start giving new priorities to any governmental unit, not only the FCC but other governmental units which may be for a priority, it means they are going to get a bigger share, and the average creditor will get a lesser share. These others may be trade creditors who need some payout in bankruptcy.

Similarly, in chapter 11, if we take this off the top, if we start giving new priorities, the debtor is going to have less of an ability to reorganize. Again there are going to be less assets in the estate—less distribution for all of the creditors.

I think you have heard enough about the exception to 362(b)(4) today, so I won't go into that in any more detail.

Finally, retroactivity: constitutionally and according to due process in our American jurisprudence, we do not usually pass retroactive legislation absent, again, some compelling circumstances. We do not do it in the criminal context. In fact in the context of the 1978 Bankruptcy Code, it did not go into effect until 1979, Congress recognizing that this should be prospective only. Again, this plays into the FCC problem in terms of allowing it to retroactively, when there is a bankruptcy, take back a license.

But, again, I want to emphasize that I am not speaking simply about the FCC problem. I am speaking about any new priority, any legislation, and no retroactive legislation.

Thank you.

[The prepared statement of Ms. Heidt follows:]

PREPARED STATEMENT OF KATHRYN HEIDT, PROFESSOR AND VICE CHAIR, BUSINESS BANKRUPTCY COMMITTEE, SECTION ON BUSINESS LAW, AMERICAN BAR ASSOCIATION

Mr. Chairman and Members of the Subcommittee:

My name is Professor Kathryn Heidt and I have been designated to present the American Bar Association's views on the trend of certain federal government agencies seeking new claim priorities under the Bankruptcy Code.

I am a visiting professor at the University of Pennsylvania Law School and a professor at the University of Pittsburgh School of Law. I also serve as the current vice chair of the Business Bankruptcy Committee of the Business Law Section of the American Bar Association, a committee consisting of 1,500 bankruptcy lawyers, professors, and judges representing all aspects of the legal profession concentrating on business bankruptcy law. In that capacity, I have been authorized to express the position of the American Bar Association, and its more than 400,000 members, on the important issues raised in this oversight hearing.

The ABA appreciates the opportunity to present testimony to this distinguished Subcommittee. We welcome the opportunity to work with you and your staff to improve the law and serve the interests of the public.

ABA RESOLUTIONS

The ABA House of Delegates has deliberated on bankruptcy policy regarding priorities and regarding the best procedures for amending the Bankruptcy Code in this regard. In 1991, the House of Delegates passed the following resolution:

RESOLVED, that the American Bar Association opposes the amendment of the Bankruptcy Code by a legislative process which avoids fair opportunity for open hearings, on well-publicized notice, before the Judiciary Committees of Congress (the Committees in whose jurisdiction bankruptcy legislation is vested); and it is

FURTHER RESOLVED, that the American Bar Association opposes the enactment, in the absence of the most compelling circumstances, of special interest legislation designed to increase the types of claims entitled to priority under the Bankruptcy Code.

A copy of the ABA's policy and the accompanying report is attached as *Appendix A*.

The first part of this resolution is about *process*. The ABA believes that bankruptcy legislation should be enacted only after an opportunity for full and deliberate hearings before the House and Senate Judiciary Committees and their relevant subcommittees.

The second part of this resolution recognizes that Congress has always given priorities to certain governmental claims to a limited extent. However, the ABA resolution takes the position that no *new* priorities should be granted without careful consideration and in the absence of compelling circumstances.

The primary function of the bankruptcy process is to gather together an insolvent debtor's assets and to distribute those assets fairly among the debtor's creditors. This policy is modified somewhat by the establishment of priorities—payments "off the top"—to accomplish certain limited goals.

The Bankruptcy Code allows, for example, a first priority for costs of administration, i.e. costs incurred during the administration of the bankruptcy estate after the bankruptcy petition is filed. This historical priority recognizes that, in order to encourage suppliers to provide the goods and services needed to preserve or enhance the bankruptcy estate, and in order to encourage lawyers and others to perform required services, they will have to be paid in cash or at least be promised "good payment."

Although some priorities are necessary in the Bankruptcy Code, a major reason that the bankruptcy laws, and particularly the Chapter 11 reorganization process, have worked well in the United States is that priority payments are relatively limited. For these and other reasons, the ABA believes that new priorities should not be created under the Bankruptcy Code absent compelling policy or practical circumstances.

When priorities are created, two factors are important:

1. In a case where the debtor is liquidating, a priority takes money out of the pool for other creditors. This includes trade creditors whose business may depend upon some recovery.
2. In a reorganization case, these priorities must be paid up front, which hampers' and sometimes may even preclude—the ability to reorganize.

When Congress considers whether a new priority is necessary and appropriate, these factors should be taken into account. As discussed below, we believe that Congress, not the courts, should make these important decisions.

THE EXCEPTION OF 362(B)(4) OF THE BANKRUPTCY CODE

Section 362(b)(4) is intended to allow governmental units to continue their regulatory roles despite bankruptcy. Of course, no one wants bankruptcy to be a haven for lawbreakers. Nonetheless, the current statute contains an ambiguity. The text of the section is as follows:

§362. Automatic Stay

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay'

(4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction, opened for signature on January 13, 1993, to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit's or organization's policy or regulatory power.

The basic ambiguity is when the regulatory interest is intermeshed with the regulatory agency's pecuniary interest. For example, everyone would agree that the regulatory interest would allow an agency to continue to enforce anti-pollution laws. However, the question arises with regard to the costs of cleanup of pre-bankruptcy environmental regulations.

THE REGULATOR AS CREDITOR

There are two ways to deal with the regulator or government as creditor. Congress can legislate on the issue. Alternatively, bankruptcy judges can decide issues as they come before them. The ABA believes that we need legislation on this subject to resolve, on a uniform national basis, the important policy and social issues involved. The ABA believes that a legislative solution, arrived at in the deliberative manner referred to above, is the best solution.

RETROACTIVITY

For legal reasons involving due process and other constitutional considerations, and also for reasons of basic fairness for those that arrange their legal affairs with a view towards existing law, the American Bar Association believes that any legislation in this important area should be prospective only.

Most American laws are designed to operate prospectively. Although Article 1, Section 9 of the U.S. Constitution only expressly prohibits the enactment of retroactive criminal statutes, the same equitable principles should apply to many retroactive civil statutes as well. Generally speaking, it is fundamentally unfair to change rights that existed, and on which citizens relied, prior to the time that Congress changed the law.

When the Bankruptcy Reform Act of 1978 was enacted in November, 1978, it was to govern bankruptcy cases prospectively. The Act specified an effective date of October 1, 1979, and all bankruptcy cases in existence prior to that date continued to be governed by the Bankruptcy Act of 1898. Congress' decision to make the new law prospective was entirely appropriate and proper, and it allowed businesses throughout the country to plan accordingly.

For these reasons, the ABA encourages Congress to avoid retroactive amendments to the Bankruptcy Code.

CONCLUSION

The ABA policy is to promote deliberate decision-making when significant changes to the Bankruptcy Code are made. Such deliberations are necessary with respect to the Bankruptcy Code in general and the Code's priority scheme in particular. The ABA's policy is also to dissuade, absent compelling circumstances, the creation of new claim priorities, and to dissuade the creation of Bankruptcy Code amendments that are retroactive in nature.

Should you wish further input on this or other bankruptcy subjects, the ABA and the Business Bankruptcy Committee would be pleased to provide them.

Mr. GEKAS. We thank the witness.

And we turn to Mr. Robin.

STATEMENT OF LOUIS S. ROBIN, ATTORNEY, ON BEHALF OF THE COMMERCIAL LAW LEAGUE OF AMERICA

Mr. ROBIN. Thank you.

I think most of the panel members have said a lot that I was going to say, and I will try to limit my discussion to just a couple of points.

The Commercial Law League is primarily, I think, concerned about the delicate balance that the Bankruptcy Code has already struck in balancing the different interests of the different parties. If the FCC is given an additional exemption, that is going to work to the detriment of other creditors. And upon attempted reorganization the result will really be a liquidation. And that will not only work to the detriment of trade creditors, as the Professor has just pointed out, but to other creditors including governmental unities, including taxing authorities and the like who will not receive any return on their claims in the bankruptcy case.

The other points, I think, about the automatic stay and the other provisions are also well taken.

I would like to add one other point or one other perspective. I practice in Springfield, Massachusetts. My clients and myself rarely have an opportunity to be an FCC case. So, the specific issue here probably won't affect them or myself. But on the same hand, I have had 20 years of bankruptcy experience, and I clerked for a judge in the southern district of New York in 1980 as a student law clerk. And at that time we had the opportunity to compare the old Bankruptcy Act, which was expiring, and the new Bankruptcy Code, which was now coming into play. And the new Bankruptcy

Code was efficient and simple, and the old act had, by amendments and changes over 80 years, had become a little rundown. Since then the new Bankruptcy Code has had other amendments. There has been additional exceptions of discharge, additional priorities, but has been relatively smooth.

My concern personally that, although, again, my practice and my clients won't be affected, that if we continue to chip away from the efficiencies of the Bankruptcy Code and provide one more exception, that the efficiencies will be denied to the debtors and the creditors that they deserve.

I thank you for the opportunity to speak on behalf of the league. Thank you.

[The prepared statement of Mr. Robin follows:]

PREPARED STATEMENT OF LOUIS S. ROBIN, ATTORNEY, ON BEHALF OF THE COMMERCIAL LAW LEAGUE OF AMERICA

The Commercial Law League of America ("CLLA"), founded in 1895, is the nation's oldest organization of attorneys and other experts in credit and finance actively engaged in the fields of commercial law, bankruptcy and reorganizations. Its membership exceeds 4,600 individuals. The CLLA has long been associated with the representation of creditor interests while at the same time seeking fair, equitable and efficient administration of bankruptcy cases for all parties involved.

The Bankruptcy Section of the CLLA is comprised of approximately 1,600 bankruptcy lawyers and bankruptcy judges from virtually every state in the United States. The members of the Bankruptcy Section include practitioners with both small and large practices, who represent divergent interests in bankruptcy cases. The CLLA has testified on numerous occasions before Congress as experts in the bankruptcy and reorganization fields.

Recently, the Federal Communications Commission (the "FCC") has undertaken efforts to require that licenses granted by the FCC be excluded from property of the bankruptcy estate and that the FCC itself be excluded from the provisions of the Bankruptcy Code. Toward this end, the FCC has urged the Congress to enact legislation that would, in effect, terminate such a license upon the commencement of a bankruptcy case by the licensee. In addition, where funds are owing to the FCC that stem from the acquisition of the license, the FCC seeks to be fully excluded from the various provisions of the Bankruptcy Code that are designed to afford orderly and equitable treatment of all creditors of the debtor and the debtor itself.

The CLLA is concerned about both the effect of the efforts of the FCC and the manner in which it has attempted to bring about legislative changes to the Bankruptcy Code. Because a business bankruptcy case involves a great variety of interests, including those of employees, taxing authorities, trade creditors, and even the local community, the Bankruptcy Code strives to achieve fairness through a careful balancing process that has as its ultimate goal the rehabilitation of a financially troubled entity.

Any change that would tip this delicate balance in the favor on one particular interest, in this instance the FCC, must be thoughtfully considered in light of competing interests. Affording special treatment to any party in interest in bankruptcy necessarily correlates in a detriment to other parties involved in the case, if not all of them. The favorable treatment sought by the FCC must, therefore, be supportable by public policy considerations that justify the harm that will be occasioned.

It is the longstanding and fundamental policy of Congress that reorganization of financially troubled businesses is to be preferred over their liquidation. The gravamen of the position of the FCC is that this policy should not apply in any case in which an FCC license is involved.

As is perhaps natural, the FCC appears to view the bankruptcy process in a vacuum, taking account of its own interest without regard to the many other interests at stake or the policy that prefers business rehabilitation. Unique to the FCC in its attempts to protect its own interest, however, is the consequent elimination of an entire class of business concerns from the reorganization process.

As a practical matter, the license itself is generally the only asset of value to the affected business as a going concern. Without the license, other assets of the business have no meaningful value and the business itself has no ability to reorganize. Liquidation of these businesses is assured under the policy sought by the FCC and, without the license, creditors, including other governmental entities such as the taxing authorities, are similarly assured that they will receive little or nothing on their claims against the estate.

The harm that will follow should the position of the FCC become law cannot be overstated, particularly since the FCC believes that its power to revoke or terminate a license solely on the basis of a bankruptcy case being commenced should apply retroactively. Creditors and other parties in interest that have relied on the existence of the license and the possibility of successful reorganization will surely be harmed by a legislative disruption of their relationships with existing debtors. Licensees not in bankruptcy will also be affected because financing may be difficult, if not impossible, to obtain in the future. Taken to its extreme, the FCC policy could bring about the liquidation of an even greater number of licensees because of the resultant inability of the licensees to obtain financing as necessary in the operation of their otherwise viable business ventures.

Compounding the problem is the wholesale removal of the FCC from the jurisdiction of the bankruptcy courts. The FCC seeks not only the power to remove the license from the bankruptcy estate, it believes this should be accomplished without regard to the automatic stay. Unlike virtually every other person having an interest in property belonging to the bankruptcy estate, the FCC would not be required to provide any justification whatsoever in order to exercise full control over the license. Instead, solely by operation of law, the license and its value will simply evaporate.

Sound public policy cannot support the position of the FCC. Its position does not sufficiently distinguish an FCC license from other types of property that, without question, belong to the bankruptcy estate. Moreover, the position of the FCC does not comport with the policy that reorganization is to be preferred, nor the statutory mandate that bankruptcy, in and of itself, may not be used as a basis for discrimination.

Should the Congress believe that the FCC is entitled to protection not already afforded by the Bankruptcy Code, it should achieve its goal through a process that fits within the existing bankruptcy framework. The automatic stay, for example, already provides an exception to allow a governmental entity to enforce its police and regulatory power, but this exception may not be used to further a purely pecuniary interest. The FCC should be treated no differently. If, in a specific case, the FCC believes it must be permitted to exercise its regulatory power, its actions should be subject to review by the bankruptcy court in the same manner currently required of all other governmental bodies.

Perhaps more important, any change with respect to the FCC in the bankruptcy process should occur through the appropriate forum. That is, any amendment that affects the bankruptcy process must be made to Title 11 of the United States Code, consideration must take place within the committee having jurisdiction over bankruptcy laws, and a meaningful opportunity to voice concerns must be given to those who have an interest in this issue.

In conclusion, the CLLA believes that the position of the FCC with respect to its role in the bankruptcy process is unwarranted and ill-advised because the harm that will befall all other parties in interest far outweighs the concerns of the FCC.

The CLLA is thankful for the opportunity to comment on this very important issue and welcomes the further opportunity to fully participate in consideration that will maintain the Bankruptcy Code's careful and balanced provisions.

Mr. GEKAS. Yes. We thank the witness.

The Chair yields itself 5 minutes for the purpose of some posing questions.

Professor Heidt, you state that you dislike the prospect of creating priorities. In the case that we are discussing here, the priority would be that if the FCC were to take back these license assets, they in effect would be granted a priority. I know you spoke generically as to what the ABA feels about this, but relating to this case, is that where the priority lies; is that correct, or the prospective priority?

Ms. HEIDT. Yes. In other words, it is not a priority that shows up in section 507 where most of the priorities are listed, but in effect what the FCC would be doing is getting a priority by being able to take the license back.

Mr. GEKAS. Does Professor Baird agree with that?

Mr. BAIRD. Yes. I think with the following two small qualifications. I think the FCC, as like someone who sells anything else, can always retain a security interest, and if they did that and if they jumped through the right hoops, they might be entitled to be paid, and that might be described as a priority.

But one of the fundamental principles of reorganization is that you are entitled to the value of your right. You are not entitled to get the property back itself. If I sell a corporation a computer and take a security interest in it, in the event of default, I can't get the computer back. I get a stream of payments equal to the value of the computer. The FCC shouldn't be treated any differently. In other words, it isn't simply there shouldn't be a statutory priority, an issue I agree with. If they bargain for a priority on the same terms as any other lender, then you respect that.

But it would be terrible to, in effect, give them a priority in a way that destroys the value of the firm as a going concern, which is essentially what happens if you allow them to take it back. To look at the 19th century railroads, it is like telling a creditor with a security interest in 10 miles of track they can take the rails and take the ties. We have never allowed that to happen in bankruptcy and it shouldn't.

Mr. GEKAS. Does Professor Heidt have a surrebuttal?

Ms. HEIDT. Yes. Well, one, I would agree with everything that Professor Baird said. I also understand the proposed legislation does actually have a priority in it as well for the FCC. So, that would be something that the ABA would absolutely oppose.

Mr. GEKAS. What proposed legislation?

Ms. HEIDT. The proposed legislation that the FCC has been trying to get enacted.

Mr. GEKAS. Oh, what they presented before the Appropriations Committee in the Senate.

Ms. HEIDT. Not anything that has been proposed by Congress or the committee.

Mr. GEKAS. What they presented to the Senate.

I have no further questions.

The Chair reserves the balance of his time and yields to the gentleman from New York for five minutes.

Mr. NADLER. Thank you.

Let me ask, first, Professor Baird, you said before—I am trying to remember exactly what you said before, frankly—how would you distinguish the FCC's regulatory authority and its pecuniary interests? In other words, they claim a regulatory interest in an ability to take back the license. How would you—why are they wrong? And what is the test for the 362(b)(4)?

Mr. BAIRD. My test, at first approximation, I think there are complications when you enter into the environmental area, which I could talk about at greater length, but the test, at first approximation, is this: Would the FCC be doing what it was doing if it wasn't owed any money? In other words, if the FCC has an ironclad rule that was clearly established by its procedures that said if a licensee fails to use a license for x period of time, that would be something it would do regardless of whether it was owed money or not. That is something it is doing as a regulator. If the only reason it is acting, however, is because it hasn't been paid money, then it is a creditor.

Mr. NADLER. So, when the FCC said that it uses auctions as the way to figure out who will best use the spectrum, and therefore the inability to pay shows that they cannot use the spectrum, those are two separate things.

Mr. BAIRD. Those are two separate things. What the policy has decided, and for better or for worse, and as bankruptcy lawyers we are not second-guessing this policy, it said one way to allocate something is to turn it into property and then sell it to the highest bidder. And the person—I am from the University of Chicago; I am sympathetic with this—the idea is the person who pays the most——

Mr. NADLER. I was thinking Mr. Poser, in particular, might have been sympathetic to this.

Mr. BAIRD. But the idea is that if you sell something to the highest bidder, that will happen. Now, if you also choose to finance the sale yourself, then you are at risk if it turns out that the person that you finance can't pay you back. Now, presumably you had an interest rate that covered you or you did other things that protected yourself, but basically once you say we are going to sell something, because we think that is the best way to figure out who wants it, what you are saying is we are creating something that has the attributes of property, and once you start down that path, then the license becomes the property of the estate.

Mr. NADLER. So, the license is the property of the estate, and when I was asking Mr. Wright whether they denied that it was the property of the estate, he said he wouldn't go that far, he was making a distinction that really can't be made?

Mr. BAIRD. Yes. The question is the *Chicago Board of Trade* v. *Johnson*, the Supreme Court case from the 1920's. One of the foundations of the bankruptcy law says something like this: It is the property of the estate, but it is subject to all of its non-bankruptcy limitations. If there is an FCC requirement that ensures there isn't static in the spectrum, then the licensee acquires that.

Or to give another example, if the FCC gives the license and it says this is only for non-commercial purposes, there is now way a debtor can use it for commercial purposes. The idea is when you grant a license, the license has the attributes of property, and that is the way our bankruptcy laws have been for decades, and I see no reason to change them, and perhaps you may want to clarify them, but there is no reason to change them. And this is the foundation for——

Mr. NADLER. Now, in terms of the—the bankruptcy court found that way, and the district court found that way, and the 2nd Circuit that was cited by Mr. Wright as having overturned it, but I think the 2nd Circuit simply overturned a decision as to the monetary worth of the licenses. The 2nd Circuit has not taken a position on the basic question yet?

Mr. BAIRD. No. They had—Nextwave had an extremely aggressive fraudulent conveyance theory that they presented to the 2nd Circuit and lost. During the course of rejecting this very aggressive theory of fraudulent conveyance law, which didn't really raise these issues, the 2nd Circuit said a number of things that seemed at odds with established bankruptcy doctrine.

Mr. NADLER. Said it in dicta.

Mr. BAIRD. In dicta. You can argue that they had to say these things to get where they do. I don't think so, but the core of the 2nd Circuit opinion—and, again, Professor Heidt can review this—the core of the 2nd Circuit opinion was on the State fraudulent conveyance law, not these issues.

Mr. NADLER. So, they haven't dealt with these issues yet.

Mr. BAIRD. They haven't formally dealt with these issues, and I believe in good advocacy. There is appeals to the Supreme Court. I trust these things will be straightened out eventually.

Mr. NADLER. Let me ask Professor Heidt the following: You said that the policy of the ABA is against legislation that doesn't go through this committee—that doesn't have a hearing before this committee. And let me say I certainly think it is obnoxious for someone to try to legislate on bankruptcy law, or anything else for that matter, in core issues through the appropriations process and run the committee of jurisdiction.

But that aside, you said that we shouldn't legislate ex post facto and we shouldn't set up new priorities. If we were to legislate to say, in effect, this is the property of the estate, the 362(b)(4), whatever it is, exception does apply here, would you regard that as ex post facto or as establishing new priority or would you approve such legislation? If we were to do legislation to clarify that we mean the law to be as it has always been understood previously.

Ms. HEIDT. Right. You said that it is property of the estate? Yes, I would view that as a clarification.

Mr. NADLER. And not as new legislation?

Ms. HEIDT. Right.

Mr. NADLER. Thank you.

Mr. GEKAS. The time of the gentleman has expired.

The gentleman from Michigan is recognized for five minutes of questions.

Mr. CONYERS. Thank you very much.

I appreciated all of the testimony that has come. Can I ask everyone whether they agreed with the bankruptcy decision that originally came out as it related to 362(b)(4)? Did you think that bankruptcy judge had made an appropriate dispensation of the case?

Mr. BAIRD. I think there are—we are not talking about the fraudulent conveyance opinion, which was the first opinion. With respect to the second opinion, I think it was a correct statement of established bankruptcy doctrine. Some people may say that given the dictum in the 2nd Circuit case, the bankruptcy judge might have done something differently, but I don't take that to be the spirit of your question. I think the spirit of your question, as I understand it, is was it a sensible and coherent interpretation of what 362(b)(4) is about? And the answer to that, I think, is yes.

Mr. CONYERS. Anybody disagree? Okay, we are all together on that.

Mr. CUEVAS. I happen to practice before the judge, and the judge is speaking before my bankruptcy class tonight.

Mr. CONYERS. So, you don't want to commit yourself or what?

Mr. CUEVAS. But I will say this: That prior to Nextwave, I was involved in that bankruptcy judge's largest bankruptcy case, and I think what Congressman Graham said before is apropos, that the way I interpreted what the judge did throughout the case was to essentially reach a fair resolution of the issues, because he did not want to see the FCC deprive the creditors and the employees of the major assets in the estate, and so, therefore, I think that what he tried to do at the end, and I think it is quoted in the Wall Street Journal, was basically reach what was reasonable and fair under the circumstances, and basically achieve rough justice under the circumstances.

Mr. CONYERS. Is it the general feeling of this panel that we won't know whether any clarifying language will be needed until we get a decision from the circuit court? And when we say clarifying language, maybe that is—we may have to—suppose the decision comes out that goes far afield from the original bankruptcy court decision, and the general feeling that I get that the FCC may have overstepped their two authorities here, we may have to consider whether we want to create a provision that corrects that decision, if it goes completely against the kind of sensibilities that I am hearing here today.

So, is it not true that whatever it is that we are going to do should wait until after the decision comes out? I mean there is no way we can talk about clarifying language when we don't really know what the decision is going to be.

Ms. HEIDT. But I think that is right if you are talking about clarifying language. Of course the other point would be that the FCC has been here and is requesting a different sort of relief, and what I think this panel is saying, uniformly, is that we would be against that relief.

Mr. CONYERS. And if that were granted, then we may need to visit the bankruptcy law to make the appropriate changes. I mean, in other words, we can correct—we frequently correct court decisions that we think are seriously erroneous.

Mr. BAIRD. I think I would say that the decision about whether or not a particular court decision has led the law too far astray is the kind of judgment that you are equipped to make. Our comparative advantage is to say these are the basic principles, this is the way the law has been, this is the general shape of the law, and then when it comes time to say, wait a second, have things really gone too far away from that, that requires a subtle balancing that typically is something that you are probably equipped to do than we are.

Mr. NADLER. Would the gentleman yield?

Mr. CONYERS. Sure. But sometimes our subtle balancing isn't subtle.

Mr. NADLER. Would the gentleman yield?

Mr. CONYERS. Yes, of course, if I can get an additional minute.

Mr. GEKAS. Without objection, another minute.

Mr. NADLER. A very quick question: When is the 2nd Circuit opinion on the appeal from the second decision of the bankruptcy court expected? Any idea?

Ms. HEIDT. I think the earlier panel said before the end of the—it expected it before the end of the month.

Mr. BAIRD. It is on mandamus, so one would expect it to be relatively soon, but you can't always tell.

Mr. NADLER. Okay. It made moot what I was about to say, which was that sometimes if an administrative agency has aggressively advancing or implementing a statutory interpretation that we don't agree with, you don't have to wait for a court decision. You could simply clarify it before that came down, but that may moot that if they rule this month, certainly.

Mr. GEKAS. The time of the gentleman has expired. All time has expired.

The panel is excused with the gratitude of the Chair and of the committee.

Before we adjourn, I want the record to indicate that the National Association of Attorneys General was scheduled to testify through one of their representatives, but they couldn't muster a witness quickly enough. However, they have asked us, and without objection I will do so, to enter into the record their proposed testimony.

[The prepared statement of Ms. Heitkamp follows:]

PREPARED STATEMENT OF HEDI HEITKAMP, ATTORNEY GENERAL, STATE OF NORTH CAROLINA

OFFICE OF ATTORNEY GENERAL,
STATE CAPITAL,
Bismarck, ND, April 10, 2000.

Hon. HENRY J. HYDE, *Chairman,*
Committee on the Judiciary,
House of Representatives, Washington, DC.

Hon. JOHN CONYERS, JR., *Ranking Member,*
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR GENTLEMEN: I appreciate receiving the invitation from your committee to participate in an oversight hearing on the 1998 amendment to the automatic stay provision of the Bankruptcy Code. As Chair of NAAGs Bankruptcy and Taxation Working Group, I am strongly supportive of this provisions and would welcome the chance to appear and discuss the ways in which the language is relevant to our efforts to protect our citizens. Unfortunately, due to the short notice and pro commitments, I am unable to attend. I have prepared testimony on this issue, however, and I would request that it be entered into the record of this hearing.

In my view, the amendment to the automatic stay provision is a welcome and needed clarification of the law. If government is to do the job its citizens have entrusted it with, then it needs to be sure that it can proceed even if a defendant files bankruptcy. Congress has long recognized that any stay of litigation must allow police and regulatory actions to go forward so that bankruptcy does not become a haven and means of delay for those who break the law and abuse their fellow citizens. The amendment merely clarified that the government could still proceed even if its police and regulatory action would impact on property of the estate—a position consistent with the holdings of most courts. It did not attempt to change the definition of a police and regulatory action with respect to purely pecuniary actions by a governmental unit. The amendment did intend to make crystal clear, however, that the government could revoke a permit issued to a landfill that was leaking toxic wastes into the groundwater, or close a nursing home that was neglecting patients, or require a factory to install safety equipment, even if those orders would affect the property in the bankruptcy case.

I believe the need to ensure that governments can act efficiently and effectively to provide those protections for all of its citizens is critical. Moreover, if parties are allowed to effectively escape the requirements of the law merely by filing bankruptcy, this will allow them to complete unfairly with their competitors who are living up to those same obligations. For all of these reasons, I strongly urge the committee to leave this provision unchanged and to once again reaffirm Congress' commitment to ensuring that bankruptcy does not provide a safe harbor for wrongdoers. If the committee has any questions or wishes further comment, please feel free to communicate with me at (701) 328–2210 or contact the Bankruptcy Counsel for the National Association of Attorneys General, Karen Cordry, at (202) 326–6025.

Very truly yours,

HEIDI HEITKAMP, *Attorney General, North Dakota, Chair, NAAG Bankruptcy and Taxation Working Group.*

STATEMENT

I would like to thank the Committee for extending the invitation to appear and testify at this oversight hearing on the 1998 amendment to the automatic stay provisions of the Bankruptcy Code, which provided much-needed clarification of the exceptions applicable to governmental police and regulatory enforcement actions. Those in government who deal with such enforcement issues view this provision as perhaps the most important in the entire Bankruptcy Code in that it ensures that the bankruptcy courts do not become havens for those who violate the law. We have no doubt that the vast majority of those who file bankruptcy are the classic "poor but honest debt that the Code seeks to protect and this provision will have no application to them. The exception for police and regulatory powers, however, is of vast importance, when the government has been pursuing an unscrupulous sweepstakes operator who has been defrauding the elderly and the unsophisticated, or a fraudulent stockbroker who has stolen millions from investors and has been busily hiding those gains, or a polluter who is spilling hazardous waste into the environment. It is not uncommon in such cases for the defendant to file bankruptcy just when the government's efforts to crack down on the violations of the law have finally begun to bear fruit. By doing so, these parties hope to delay the day of reckoning and avoid returning their ill-gotten gains to their victims.

Standing alone, the broad language of the automatic stay in Section 362(a) of the Code would allow exactly that result, by barring all litigation relating to repetition claims or to actions that would assert control over property of the estate. However, Congress wisely chose in 1978 to also include exceptions to the automatic stay in Sections 362(b)(4) and b(5) so as to ensure that governmental police and regulatory actions would go forward unchecked. Those provisions allowed the government to continue litigation on police and regulatory actions and to enforce judgments obtained in such actions, except for strictly monetary judgments, which had to be submitted for payment iff-accordance with the Code's priorities. That language worked well for most cases but issues did arise from time to time because of the limited nature of the exception that was provided. Most of the exceptions in Section 362(b) relate to all aspects of the stay, but the governmental exceptions only dealt directly with two subsections of the stay. In particular, the exceptions did not explicitly deal with portions of the stay that barred actions that could affect property of the estate or that could be viewed as attempts to collect on a claim.

As a result, arguments were made that the government could decide, for instance, that the permit for a landfill should be revoked because the operator was allowing dangerous chemicals to leach into the groundwater and endanger his neighbors—but the government could not actually revoke the permit until it came back to the bankruptcy court and got its approval to do so. The argument was also made that even a typical regulatory litigation would violate the ban on trying to collect on a claim because a determination of liability was the necessary first step before collection activities could begin. Even prior to the amendment being passed, many courts rejected these arguments, including most prominently the Sixth Circuit in the *In re Javens case*, 107 F.3d 359 (1997), and the Tenth Circuit in the *In re Yellow Cab Co-Op Ass'n* case, 132 F.3d 591 (1997). In their view, it would make no sense to conclude that the government was free to make the substantive determinations in this area but could not implement them without a ministerial action by the bankruptcy court to lift the stay to allow the action to go forward. There, are often times where timely action is of utmost importance to enforcing the law; involving another court that would have no expertise in the area or involvement in the case at the last minute would cause nothing but delay, added cost, and confusion. However, some courts did feel that exactly this sort of bifurcated process was required under the existing law, even if they saw the problems that were caused thereby. See, e.g., *In re Draughon Training Institute, Inc.*, 119 B.R. 921, 925–926

Several governmental entities raised this issue with the National Bankruptcy Review Commission during its processes and proposed language to remedy the issue. That language, with the addition of references specifically to the unique aspects of the chemical weapons inspection process, is what eventually became law in the 1998

Chemical Weapons Treaty Implementation Act. In our view, it has worked well since then to eliminate unneeded litigation and delay in this area. Moreover, we believe that, properly understood, there is no conflict between these exceptions and the overall policies and goals of the bankruptcy system. That is because the bankruptcy system serves to protect and maximize the assets and interests of debtors and creditors—*within the existing regulatory framework applicable to all entities in this country.*

The notion of a conflict only arises if one believes that asset maximization is a goal wholly apart from and superior to all other aspects of our system. That is obviously untrue, though. Businesses could often make more money if they had no obligation to preserve the environment, refrain from hiring children, or to supply a safe work place for their employees. But no civilized society operates on that basis and our laws clearly reflect the hard choices made by Congress in deciding how to balance economic interests against other goals and values. In the process of making those policy choices, legislators are often confronted with arguments about the economic impact of their decisions, and must weigh those arguments in shaping the laws. But., when those choices are made, they must then be enforced by the courts without attempting to second guess or underinine the policy choices. made by the elected representatives of the people. That is true in ordinary litigation—and it is equally true when a company files for bankruptcy.

A law that can only be enforced until the defendant unilaterally chooses to file bankruptcy is no law at all. Allowing the wrongdoer to decide for itself that it would simply cost too much to comply with the law nullifies the Congressional policy choices and provides an unfair advantage to the debtor, as compared to its competitors who *are* being required to abide by the law. Setting aside the law on a case-by-case basis will only result in a rush to the courthouse and a race to the bottom. This is simply not a power that can or should be exercised within the factual confines of a single case. It may well be that a law, in application, turns out to have of a fiscal impact than Congress or a state legislature envisioned. The 1997 amendments on health care financing might turn out to be such a case. But, if so, it is up to the legislative branch looking. at the health care needs of the country as a whole—to make the decision on how to revise that law in order to deal with its financial impact on health care providers. It cannot be left to hundreds of unelected judges to decide on a piecemeal basis, whether or not to excuse a debtor from the obligations of that law. That sort of decision-making process, on a case-by-case basis. with no overriding vision or obligation to deal with *all* of the competing interests in the health care arena is a recipe for chaos.

Thus, when the government continues to enforce the law against the debtor, there is no conflict with the Bankruptcy Code because the Code does not purport to provide debtors with a "Get Out of Jail Free" card that exempts them from compliance with-the legal obligations applicable to all players in the market. There are certain limited places where the Code does specifically override nonbankruptcy law, such as with respect to declaring contracts in defaults based on a bankruptcy filing, but there is most assuredly no general amnesty for debtors. To the contrary, Congress has explicitly stated in 28 U.S.C. 959(b) that the debtor and the trustee *must* obey all generally applicable state laws in their operations during the case.

Will those regulatory provisions impact on the property of the estate from time to tine? Of course. How could they not? But does that mean that all such activity should come to a stop until one can turn to a bankruptcy court, file a motion, have a hearing, and obtain a determination that the stay should be lifted—and then wait through a series of appeals on that determination? Again, that would be a recipe for chaos and abuse. Start with a very easy example a restaurant files for bankruptcy. If the health inspector make a routine visit and discovers that the facilities are filthy and infested with vermin, is he required to allow the restaurant to continue to operate until he can go to the bankruptcy court and get the court's permission to order an immediate shut down of the restaurant? The Washington Post contains a listing every week of the restaurants that are subject to such immediate clean-up orders. Should the same provisions and controls not apply merely because the restaurant is in bankruptcy? Yet, absent the clarifying language in the present Section 362(b)(4), that argument could be made, with health inspectors facing the threat of being called into bankruptcy court to answer contempt charges for doing their job and protecting the public.

Take another example—the state of California may conduct inspect shipments of produce to ensure that they were not infested with the Mediterranean fruit fly. If the inspectors find an infected load would the state be precluded from ordering the immediate destruction of that load in order to protect the multi-billion dollar industry in the state, merely because the fruit belonged to a company that was in bankruptcy? Would the state have to hold the items for days or weeks, while it tried to convince a judge of the reasons for the enactment of the generally applicable state law? If asset maximization were the only goal of bankruptcy, then as some seriously suggested in hearings before the Bankruptcy Review Commission, the United States should go ahead and sell goods that had been seized from debtors because they were made with child labor or were counterfeit or misbranded. Those advancing such a view were hard-pressed to explain how the goals to be served by laws requiring such goods to be forfeited would be served if the government became the counterfeiter instead of the debtor. Neither the debtor, nor its creditors, have a right to demand that their economic interests allow them to violate generally applicable law.

We take no position on the issues involving the FCC's licensing procedures. Those actions involve, in our view, a single law that, according to the opinion of the Second Circuit. uses a virtually unique scheme of auctioning licenses as part of the means of implementing a regulatory goal. The applications that state government typically make under under this section. though, are far more commonplace. One major area where permits are involved, for instance. is environmental regulation. Such permits do generally spell out, in great detail, how a landfill will operate, or what level of emissions are allowed from a smokestack, or how many gallons of waste can be discharged into a stream. Unquestionably, the granting or revocation as such permits will impact on the operation of the debtor, but it is crucial to protect the public health and safety that such a regulatory process be allowed to proceed. Such matters are normally entrusted-to specialized agencies with ongoing expertise and established review procedures. There is little reason to think that bankrupt by courts have the expertise or the time to become involved in the minutiae of such regulation., Such permits are generally issued for either a nominal fee or for a fee that is related to the costs actually incurred by the agency in carrying out its oversight role. Few, if any, other types of government permits and licenses are auctioned. Even those licenses that can become quite valuable, such as liquor licenses or cab medallions, are normally transferred by the government at nominal cost. The costs are incurred between private parties who are paying each other for the right to make application to the government to transfer the license.

Government regulations that may impact on property of the estate may include matters as mundane as pulling over trucks that fail safety inspections, or ordering that the debtor buy and install guards for the machinery in his plant. They may also include the more dangerous and exotic aspects of commerce—utilities that operate nuclear power plants have gone bankrupt; ammunition manufacturers have gone bankrupt, and, yes, even chemical weapons manufacturers may go bankrupt. In each case, there may be occasions where ongoing law enforcement activities will, inevitably, impinge on the use or control of property of the estate. This is particularly true in light of the very broad definition given to property of the estate under the Code. Thus, to try to artificially divide regulatory activities and exempt those that will impact on that property will only invite endless litigation over what is property and cripple law enforcement actions.

We do not suggest that there are never occasions where laws and regulations cannot or should not take financial distress into account. But, we do believe the decision to do so should be made by those who can be held accountable for choosing to allow such discretion and should be done with full consideration of all of the competing interests. The very nature of decision-making in a litigated environment, with only one set of parties and one set of interests clearly before the court, while the competing interests can only be vaguely glimpsed, cannot help but result in a skewed result.

In short, we strongly believe that the 1998 amendments are a necessary and appropriate clarification of the law. Indeed, we would urge the committee to go for further and strengthen the ability of state regulators to continue to enforce their police and regulatory powers by adding language to make unmistakably clear that state courts and agencies have the ability to decide the applicability of the automatic stay and the discharge injunction to their actions. The stay is a federal law, and like any other law, all parties subject thereto must read and apply the law to their actions and refrain from violating that law. By the same token, those parties, including courts and agencies, are entitled to read the law and determine that it does *not* cover other actions and that they are free to proceed in those areas. As a practical matter if they were not empowered to make those judgments, then *every* action, no matter how commonplace, taken by someone who deals with a debtor in bankruptcy would have to be approved in advance by the bankruptcy court. That is obviously completely impractical and the vast majority of court decisions agree that every party subject to the stay has the right and ability to determine whether and how to proceed. This ensures that, in the governmental area, its regulatory and enforcement efforts are able to proceed without undue cost and delay.

Despite those rulings, however, many state courts are so cognizant of their duties to obey federal law and so fearful of running afoul of it, that they refuse to take *any* action in a bankruptcy case until they have affirmatively been approved to do so by a bankruptcy court. At least part of the reason for this is that there is no clear statement in the jurisdictional provisions of Title 28 of the United States Code that spells out the nature of the concurrent jurisdiction as between bankruptcy courts and other nonbankruptcy—courts. As a result, a debtor that files a bankruptcy petition on the eve of a state court trial scheduled to hear the government's charges of fraud, or securities violations, or environmental claims has a very good chance of being able to disrupt a trial schedule that may have been planned for months. By doing so, he can hope that, even if the bankruptcy judge immediately agrees that the stay is not applicable to the enforcement action, that rescheduling the case may take weeks or months. During that time period, witnesses may vanish, memories may fade, and proof of the case will become more difficult. At a minimum, there will be justice delayed, and additional costs and burdens imposed on both the prosecutors and the bankruptcy courts to deal with wholly unnecessary litigation. The exceptions to the automatic stay are meant to avoid exactly those problems, yet they still persist. There are similar issues with respect to whether nonbankruptcy courts are entitled to apply and decide issues regarding whether a particular debt has or bad not been discharged under the Code.

Indeed, these problems have recently been exacerbated by an unfortunate series of rulings from the Ninth Circuit in a case entitled *In re Gruntz*, 202 F.3)d 1074 (2000). This case involved a father wbo had been charged, while in bankruptcy, with a criminal failure to provide support to his children. He did not contest the state court's right to proceed (pursuant to the criminal exception to the automatic stay set forth at Section')62(b)(1)) until after he lost at trial. After further proceedings, and another criminal conviction, he again sought to have the bankruptcy court second-guess the state's right to prosecute him. The bankruptcy court commendably, did not do so, but the Ninth Circuit did. At first, it even held that the criminal prosecution was barred, but after three tries at deciding the case, it eventually concluded tbat the state court had been right all along in allowing the prosecution to proceed. But, it added, the bankruptcy court only had to pay attention to the state court if it thought the state court was rigbt. Otherwise, it could simply ignore everything the-state court action. Indeed, under this view, a debtor could take his chances in state court, appeal the matter all the way to the State Supreme Court—and even to a denial- of certioraris from the United States Supreme Court—and then go back to bankruptcy court and start over. A better prescription for delay and abuse is hard to imagine.

The Ninth Circuit was only able to reach this result (in contradiction to decisions of several other circuits) because of the lack of clarity in the jurisdictional provisions set forth at 28 U.S.C. 1334. The result is that state and local prosecutors and other enforcement officials will feel that they have little option but-to file into the bankruptcy court and get a ritualistic endorsement of their action in each case before they proceed, no matter how clear the language of the Code's exception appear to be. The alternative is to face the ever-present threat that the debtor will -be able to obtain his second bite at the apple and disrupt everything that has gone before.

These issues have been raised with staff members in the past, and if the Committee decides to review the application of the automatic stay to governmental actions, we strongly urge that this change be made part of the consideration. We are ready and willing to work with the Committee and its staff to craft language that will deal with these issues. We also stand ready to provide additional examples of the types of enforcement actions that are protected by the language of Section 362(b)(4) and to provide additional case law citations as desired. Again, I thank you for the opportunity to appear and to provide our whole-hearted support for retaining and strengthening the current language on governmental police and regulatory actions.

Mr. GEKAS. With that, and the thanks of the Chair to everyone in attendance, we conclude and adjourn this meeting.

[Whereupon, at 3:30 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF BRIEF AMICUS CURIAE ON BEHALF OF CELLULAR TELECOMMUNICATIONS INDUSTRY ASSOCIATION, BELLSOUTH CORPORATION, NEXTEL COMMUNICATIONS, INC., SBC COMMUNICATIONS, INC., AND US WEST WIRELESS, LLC

Mr. Chairman, we appreciate the opportunity to submit to your Subcommittee for the record of the Subcommittee's hearing today a Summary of the amicus brief we have filed in the NextWave litigation in the United States Court of Appeals for the Second Circuit.

The parties to this brief include the Cellular Telecommunications Industry Association, BellSouth Corporation, Nextel Communications, Inc., SBC Communications, Inc., and US WEST Wireless, LLC.

The Cellular Telecommunications Industry Association is the international organization for both wireless carriers and manufacturers. CTIA's membership includes 140 large and small cellular and broadband personal communications services providers. The other amici are engaged in the business of providing wireless communications services to the public.

The parties to this amicus brief are interested in the Second Circuit proceeding because allowing the FCC to reauction the licenses at issue would serve the American public by helping to effectuate the provision of wireless services utilizing the affected spectrum and because the integrity of the FCC licensing and auction process is dependent on compliance by licensees with the FCC regulatory requirements and, particularly, license conditions. We believe that the bankruptcy court's actions in the NextWave bankruptcy case threaten the FCCs ability to carry out its statutory mandates concerning competitive bidding and uniform application of its Title III licensing functions.

Your hearing today reviewed the issues that are presently before the Second Circuit. We have commented on these issues in our amicus brief and want to make the Committee aware of our views. We strongly believe, and have strongly urged, that the FCCs position on license cancellation is fully consistent with the requirements of the Bankruptcy Code. The legal basis for our argument is set forth in the attached Summary. We also urge that the Committee not address issues relating to the Next Wave bankruptcy while those matters are pending before the courts and not enact retroactive legislation that would affect those proceedings.

SUMMARY

Pursuant to the Congressional mandate embodied in section 309(j) of the Communications Act, 47 U.S.C. § 309(j), the Federal Communications Commissions ("FCC") has auctioned PCS licenses as part of its overall licensing allocation scheme. Some of these auctions have been open only to designated entities ("DEs"—which received credits under the FCC's rules only if they were small or very small businesses). DEs were entities with total assets and gross revenues below set financial caps that complied with strict FCC restrictions on ownership and corporate structure. Next*Wave* Communications, Inc., purporting to qualify as a "small business," was the successful bidder for certain C Block PCS licenses on May 6 and July 6, 1996, bidding a total amount of $4.74 billion and acquiring spectrum that covered over one-half of the U.S. population. (It is hard to conceive of a bidder of approximately $5 billion as a small business. Indeed, Next*Wave's* bids foreclosed the participation of true "small businesses" from the auction.)

As a special accommodation for designated entities, the FCC offered to finance DE spectrum purchases, instead of requiring the usual full cash payment prior to license issuance. Next*Wave* paid only $474 million in cash and executed 10-year notes for the remainder to the FCC. All FCC PCS licenses are subject to a variety of conditions, including prompt payment and buildout requirements. *See, e.g.,* 47 C.F.R. §§1.2109, 24.203. The licenses acquired at the special DE-only auction were explicitly conditioned on full and timely payment by Next Wave of its remaining obligations. *See* 47 C.F.R. §1.2110(f)(4)(iii).

Next*Wave* has not offered any competitive wireless service in the more tban three years since it acquired the licenses. When Next*Wave* was unable to pay the amount it owed, it declared bankruptcy. In the course of the bankruptcy proceedings, Next*Wave* claimed tbat it should bave to pay only $ 1.023 billion for tbe licenses because the FCC had (allegedly) participated in a fraudulent conveyance (a bankruptcy term that does not connote common law fraud) by requiring Next*Wave* to pay what it bid for licenses. According to Next*Wave* the bid amount was much more than their fair market value at the time of the issuance of the conditioned licenses. In essence Next*Wave* claimed that because the licenses had purportedly declined in value after the auction, Next*Wave* should pay billions less than the auction price, thereby relieving Next*Wave* of its obligation to pay the U.S. Treasury the full bid amount.

Next*Wave's* position was unanimously rejected by the United States Court of Appeals for Second Circuit on December 22, 1999. *In re NextWave Personal Communications, Inc. (FCC* v. *NextWave Personal Communications, Inc.*), 200 F.3d 43 (2d Cir. Dec. 22, 1999). The Court of Appeals held that Next*Wave's* payment obligation was not merely a debt within the jurisdiction of the bankruptcy court. Rather, the licenses were subject to a valid regulatory condition of full and timely payment and could be revoked for nonpayment consistent with the bankruptcy laws. The Court of Appeals stated explicitly:

> *If the conditions to which a license is subject are not met, the FCC may revoke the license. It is beyond the jurisdiction of a court in a collateral proceeding [i.e., a bankruptcy matter] to mandate that a licensee be allowed to keep its license despite its failure to meet the conditions to which the license is subject.*
>
> When the FCC decides which entities are entitled to spectrum licenses under rules and conditions it has promulgated, it therefore exercises the full extent of its regulatory capacity. Because jurisdiction over claims brought against the FCC in its regulatory capacity lies exclusively in the federal courts of appeals, *see* 28 U.S.C. §2342, 47 U.S.C. §402, *the bankruptcy and district courts lacked jurisdiction to decide the question of whether NextWave had satisfied the regulatory conditions placed by the FCC upon its retention of the Licenses.*

Id. at 54 (emphasis supplied).

Thus, the Court of Appeals stated that "the FCC may revoke the license," if the conditions are "not met," *id.* at 5, and that "it would probably be fair to assume that the FCC will seek to revoke the Licenses." *Id.* at 59 n. 15. On January 12, 2000, tbe FCC announced that the licenses had been canceled for failure to meet the full and timely payment condition.

Having lost in the Second Circuit, Next*Wave* completely reversed course and now claims that the licenses are worth more than it agreed to pay. Next*Wave* seeks to retain the licenses despite its failure to make the required payments and thus to reap tbe pecuniary benefits of tbe increase in the value of the licenses. Next*Wave* challenged the FCC's cancellation action before the FCC and in the District of Columbia Circuit. Next*Wave* also sought to have the bankruptcy court void the cancellation. The bankruptcy court agreed with Next*Wave* and ordered the FCC to void the cancellation. Contrary to the Second Circuit decision, the bankruptcy court reasoned that the FCC acted "as a creditor" rather than "in any regulatory capacity," and therefore that the FCC's cancellation of the licenses was prohibited by the Bankruptcy Code's automatic stay of proceedings. At the request of the FCC, the Second Circuit agreed to entertain a mandamus proceeding to decide whether the bankruptcy court decision was consistent with the Court of Appeals's earlier decision and mandate. Both sides have submitted briefs, and the matter remains pending.

These parties have filed an amicus brief supporting the FCC and urging that if Next*Wave*'s position were adopted, important policies of the Communications Act would be subverted. That brief makes the following points:

1. There was no unfairness to Next*Wave* from the license cancellation. Next*Wave* accepted the licenses with full knowledge of the conditions. Next*Wave* made a conscious choice to litigate in the hope of retaining valuable licenses for a greatly reduced amount of money rather than making the required payments

2. The decision of the bankruptcy court reflects a radical departure from the Court of Appeals ruling and established bankruptcy law. Indeed, the reasoning of the bankruptcy court's most recent decision is virtually identical to the reasoning of the very decisions reversed by the Court of Appeals's December 22 Ruling. While as a general matter the FCC licenses are subject to the Bankruptcy Code, in this specific instance the FCC was exercising regulatory authority concerning the allocation of spectrum, and thus its actions are permitted by the Bankruptcy Code.
3. As the Court of Appeals has already found, there is no basis to permit a bankrupt licensee to escape license conditions: "In granting licenses by auction, the FCC acts as creditor and regulator both." 200 F.3d at 59 (emphasis supplied). The Court of Appeals specifically found that the FCC's "full and timely payment" requirement is "a regulatory condition" that "has a regulatory purpose related directly to the FCC's implementation of the spectrum auctions." 200 F.3d at 52. The FCC's rules and regulations—including the "full and timely payment" requirement—"express the FCC's expert judgment as to the course that would best promote congressional objectives and serve the public interest, [and] thus manifest substantive regulatory decisions about the allocation of spectrum." Id. at 53 (emphasis supplied). Thus, the Court of Appeals detennined that the FCC's exercise of its regulatory power, including its enforcement of license conditions, cannot be reviewed by a bankruptcy court. As the District of Columbia Circuit has also found:

   > An FCC licensee takes its license subject to the conditions imposed on its use. These conditions may be contained in both the Commission's regulations and in the license. Acceptance of a license constitutes accession to all such conditions.

   P&R Temmer v. *FCC*, 743 F.2d 918, 928 (D.C. Cir. 1984) (citation omitted).
   The great weight of authority, including decisions in the First, Second, and Tenth Circuits and numerous other lower court decisions, establishes that conditions upon government licenses, including FAA landing slot permits, liquor licenses and race track licenses, many of which have payment requirements, are properly enforced even in bankruptcy, and that a bankruptcy court cannot alter license conditions.
4. There was no unfairness to Next*Wave*. The bankruptcy court did not bar Next*Wave* from making the necessary payments to satisfy the conditions during the course of the bankruptcy proceeding. As the bankruptcy court repeatedly acknowledged, Next*Wave* could have sought authority to make payments and such payments would have been permissible if made "pursuant to court order." It was incumbent upon Next*Wave* to seek and obtain authorization from the bankruptcy court to make the required payments. Next*Wave*'s choice to litigate in an effort to minimize or eliminate those payment obligations rather than requesting authorization to make payments does not excuse its failure to comply with the timely payment condition.
5. The cancellation did not violate the automatic stay. Section 362(b)(4), the automatic stay provision, excepts any action by a "government unit" to enforce its "police and regulatory power." 11 U.S.C. § 362(b)(4). Numerous cases, including those from the Second, Third, Ninth and Tenth Circuits, have held that this provision is not limited to "health and safety" regulation, but covers payment standards and requirements so long as they incorporate a "regulatory," rather than a solely "pecuniary," purpose. Moreover, in 1998 Congress amended Section 362(b)(4) to ensure that regulatory efforts to exercise control over property of the estate are exempt from the automatic stay. Because cancellation of the licenses based on the debtors' failure to comply with the "full and timely payment" requirement served "primarily a regulatory purpose," it necessarily fell within the scope of the Section 362(b)(4) exception. This exception to the automatic stay serves important public policy purposes by permitting crucial regulatory action affecting the public interest.
6. The bankruptcy court's decision is replete with attempts to review and redetermine the FCC's regulatory authority and its exercise of that authority in canceling the licenses. Indeed, such review and redetermination was the bedrock of the bankruptcy court's decision. Under the Communications Act, once the FCC has rendered its decision, exclusive review of licensing decisions rests in the "United States Court of Appeals for the District of Columbia." 47 U.S.C. § 402(b). Congress specifically amended that section in 1952 to provide that the District of Columbia Circuit has "exclusive" jurisdiction. In-

deed, Next*Wave* has already appealed the cancellation of the licenses to that Circuit.

7. The bankruptcy court found that, if the FCC "were permitted to reclaim Next*Wave*'s licenses, that result would violate the debtors' statutory right to "cure defaults" in a plan of reorganization under Sections 1123(a)(5)(G) and 1124(2)(A) of the bankruptcy code. This again ignores the Court of Appeals's holding that the FCC acts primarily in its regulatory capacity, and not in its capacity as a creditor, when it cancels a license for the licensee's failure to meet license conditions requiring full and timely payments.

The authority granted by Section 1123(a)(5)(G) of the Bankruptcy Code to "cur[e]" or waiv[e]" any "defaults" in the debtor-creditor relationship in a plan of reorganization does not constitute a statutory pre-emption of the FCC's exclusive right to enforce its police and regulatory powers in response to a debtor's non-compliance with applicable laws and regulations.

8. The bankruptcy court also suggested that the FCC's cancellation of the licenses "appears" to have violated the anti-discrimination provision of Section 525(a) of the bankruptcy code because the facts "would appear to present a clear and convincing *prima facie* case of retaliation" by the FCC.

The Bankruptcy Court's suggestion that the FCC's actions constitute unlawful 66retaliation" was predicated entirely on its finding that there is no "comprehensible regulatory objective" for the FCC's enforcement of the "timely payment" condition. That finding simply ignores the Court of Appeals's holding that the FCC's enforcement of the "full and timely payment" condition is a proper exercise of the FCC's substantive regulatory authority.

Next*Wave* has alleged that the FCC had treated Next*Wave* differently from other C Block license holders, but that allegation is also without merit. The FCC has provided clear notice that it will cancel licenses for failure to meet payment conditions and has consistently canceled licenses for non-payment. Moreover, even if Next*Wave*'s allegations of differential treatment were supportable, the FCC's actions would not constitute the type of "discrimination7 against a debtor that is prohibited by Section 525 (a). The licenses were canceled—*not* because the Next*Wave* entities were "debtors" in chapter 11, *not* because they had been "insolvent" prior to or during their chapter 11 cases, and *not* because they had "not paid a debt that is dischargeable" in chapter 11, see 11 U.S.C. § 525(a)—but because Next*Wave* had failed to comply with a regulatory license condition that is nondischargeable in bankruptcy. Contentions similar to Next*Wave*'s have been rejected by the Third Circuit in an earlier case.

Approved By The ABA House of Delegates in August 1991

AMERICAN BAR ASSOCIATION
SECTION OF BUSINESS LAW
REPORT TO HOUSE OF DELEGATES

RECOMMENDATION*

RESOLVED, that the American Bar Association opposes amendment of the Bankruptcy Code by a legislative process which avoids fair opportunity for open hearings, on well-publicized notice, before the Judiciary Committees of Congress (the Committees in whose jurisdiction bankruptcy legislation is vested); and it is

FURTHER RESOLVED, that the American Bar Association opposes the enactment, in the absence of the most compelling circumstances, of special interest legislation designed to increase the types of claims entitled to priority under the Bankruptcy Code.

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*Note: The "Recommendation," but not the attached "Report," constitutes ABA policy.

Appendix A

REPORT

Background

In 1978, Congress enacted "The Bankruptcy Reform Act of 1978," Pub. L. No. 95-598, the first major overhaul of the bankruptcy laws since 1938. It was the culmination of more than ten years of effort and grew out of proposals formally presented to Congress in the 1973 Report of The Commission On The Bankruptcy Laws of the United States. H.R. Doc. No. 93-137. The Bankruptcy Code, 11 U.S.C. §§ 101-1330, reflects a series of delicate balances between the interests of debtors and creditors (including the interests of the federal government and its agencies as a creditor). Before the legislation was enacted, it was the subject of much study and debate among the bar and before Congress. Appendix 2 Collier on Bankruptcy at v. (15th ed. 1989). That extended debate allowed ample opportunity for fair comment before the legislative package became law.

In the years immediately following enactment, those legislators and Congressional staff members who had labored over the Bankruptcy Code during the prior decade formed an informal cadre whose common interest was careful consideration of proposed changes in the Bankruptcy Code. Although comprised of varying political perspectives, there was agreement on the necessity for a rational forum to consider proposed amendments to the Bankruptcy Code in light of the often unanticipated results of each change on the bankruptcy process and the effect on pre-bankruptcy dealings and negotiations. Most of that group has now retired or moved elsewhere. Bankruptcy is a necessary part of the Congressional agenda, but it is not an area with a meaningful political constituency.

Several disturbing trends have emerged. Retroactive bankruptcy enactments, the failure to hold Congressional hearings on well-publicized notice before considering

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* Although this Report is submitted by the Chair of the Business Bankruptcy Committee, much of its original draftsmanship was the work of Stephen P. Feldman, Los Angeles, California, former Chair of the Subcommittee on Legislation.

amendments to the Bankruptcy Code, and the increasing pressures by special interest groups to seek priorities or similar special bankruptcy treatment, pose threats to the bankruptcy legislation process. At its spring 1989 meeting, the Business Bankruptcy Committee considered a series of recommendations, and at its fall 1989 meeting, that Committee proposed resolutions substantially identical to those recommended in this Report. The recommendations were considered by the Council of the Section of Business Law in November 1989. At that time the Council determined to see if the trends continued and whether informal action might bring affirmative results. By the end of 1990 it became clear that some of the worst possibilities had been realized. The enactment of an Eighth Priority to the Bankruptcy Code in November 1990, without any public notice or opportunity for consideration by the bar, made clear that the time for action had arrived. The recommendations were submitted to the Council of the Section of Business Law at its meeting on January 19, 1991, and were approved for this submission to the House of Delegates.

<u>The Current Threat to the Bankruptcy Reorganization Process</u>

The primary function of the bankruptcy process is to gather together an insolvent debtor's assets and to distribute those assets fairly among the debtor's creditors. This "equality of distribution" policy is modified by the establishment of priorities -- payments "off the top" -- to accomplish certain limited goals. The Bankruptcy Code allows, for example, a first priority for costs of administration (i.e., costs incurred during the administration of the bankruptcy estate after the bankruptcy petition was filed): a recognition that in order to get suppliers to provide goods and services needed to preserve or enhance the bankruptcy estate, or to get lawyers or security guards to perform required services, they will have to be paid in cash or at least promised "good payment."[1/] Chapter 11 is designed to enhance the value of the assets by reorganizing in order to capture the "going concern value" of the debtor's business.

1/ Payments to secured creditors are not, strictly speaking, priorities: they are a return to the secured creditor of property which legally or equitably belongs to the secured creditor rather than to the bankruptcy estate (or are payments in lieu of the delivery of that property to the secured party).

A major reason that the bankruptcy laws, and particularly the Chapter 11 reorganization process, have worked well in the United States is that priority payments -- those payments which come ahead of the distributions to unsecured creditors -- are relatively limited. A constant stream of bills in the Congress would, however, provide that one or another special interest group receive priority payments in bankruptcy ahead of all other creditors. In the 101st Congress (which ended in December 1990) and in the present Congress, special interest groups have emerged to demand priorities, and at least one federal agency has used its position as a "government insider" to bring about priority legislation without any public hearing during the closing days of the last Congressional Session. Much of the legislation enacted or sought is retroactive in effect.

In the last two or three years, the most rapacious of the special interest groups has manifested itself: to-wit, government agencies with powerful Congressional constituencies. Waving the banner of the Environmental Super Fund, the Pension Benefit Guaranty Corporation, the bank and S & L crisis, and a variety of other governmental "interests," there have been proposed Bankruptcy Code amendments in Congress to provide priority to one favored governmental entity or another -- all to the virtual destruction of any opportunity for Chapter 11 reorganization or for meaningful distribution to unsecured creditors.

The 1990 Experience -- The Eighth Priority

In the final days of the 101st Congress, buried deep in the Crime Control Act of 1990 -- adopted as part of the budget reconciliation process -- the Congress enacted an Eighth Priority for unsecured claims owing to the FDIC and other bank regulators in consequence of contractual commitments to maintain the capital of insured depository institutions ("Keep-Well Agreements"). It is an example of the worst aspects of the legislative process. It was enacted without public hearings or any significant discussion with the practicing bar. The legislation is retroactive in its effect. In those instances where that legislation might be utilized, the prospect for reorganization of the affected company -- indeed, the prospect for any distribution whatever to any creditor other than the federal government -- is destroyed.

What is worse, the Pension Benefit Guaranty Corporation and other federal agencies have already introduced legislation in the current Congress to provide similar priority treatment for themselves. Not to be outdone, a number of private interest constituencies are also descending upon the Congress demanding like treatment.

The use of Bankruptcy Code amendments to address fundamental social and economic problems (such as failure to fund the bank rescue agencies, or failures to fund the pension and medical benefit programs) is haphazard at best and could be disastrous to the reorganization process. A bank rescue or PBGC priority linked only to Chapter 11 discourages the use of Chapter 11. The creation of new and uncertain priorities which may threaten institutional and individual lenders will raise the cost and decrease the availability of financing. In the long run, such legislation will impel lenders to require that borrowers pledge not to acquire banking institutions or not enter into retirement plans that provide benefits which are not fully funded. The effect will be to limit sharply the number of companies permitted to enter into such undertakings -- thus defeating the long term goals of the federal programs. The addition of a large and potentially overwhelming class to priority status will severely limit the availability, and significantly increase the cost, of goods and services to Chapter 11 debtors. Perhaps most significant, such legislation distorts the workable and equitable bankruptcy distribution pattern under current law.

Fair and equitable treatment of creditors' claims is a primary goal of the bankruptcy process. The goal is implemented through a delicate balancing of the claims of those who advanced goods or monies to the debtor or who entered into contractual undertakings with the debtor prior to the filing of the bankruptcy petition; those who extended credit secured by a portion of the debtor's assets in ways permitted by law; and those who will be called upon after the bankruptcy filing to provide goods and services to the post-petition debtor. In a Chapter 11 reorganization proceeding, those interests are in turn matched against the requirements of those who may be called upon to fund a plan of reorganization or to provide services or goods to a reorganized enterprise. That balance has emerged after almost a century of experience with bankruptcy laws in the Bankruptcy Code sections dealing with priorities (11 U.S.C. § 507); in limitations on certain categories of claims (e.g. 11 U.S.C. § 502(b)(6) and (7)); in careful definition of claims (11 U.S.C. § 101(4)) and their allowance (11 U.S.C. § 502), including taxes (11 U.S.C. § 505); in the determination and extent of secured status (11 U.S.C. § 506); and in the careful regulation of post-petition expenses (11 U.S.C. § 503) and of those who render post-petition services to the debtor (e.g. 11 U.S.C. § 504 and 11 U.S.C. §§ 326-331).

The normal reason for allowing payment as a priority cost of administration is that the payment is necessary to procure post-petition goods or services that will currently benefit the Chapter 11 estate. Other bankruptcy priorities are tied to dissuading workers or customers or taxing authorities from acting against the debtor when there is a rumor of a bankruptcy filing. None of those policies apply in the current spate of priority legislation.

In many foreign countries priorities in bankruptcy have been extended to include substantial portions of the entire welfare system, and the reorganization process simply does not work in those jurisdictions. When the required priority payments to post-petition providers of goods and services, pre-petition employees, taxing authorities, customers, or other claimants become too extensive, it becomes impossible to reorganize the enterprises (unless with the infusion of significant governmental assistance), or even to assure a reasonable distribution to unsecured creditors in liquidation. In England, therefore, there is the "floating charge" under which banks or similar institutions take possession of all of an insolvent debtor's assets and proceed to liquidate or reorganize outside of the bankruptcy process, generally without significant judicial supervision. In France, and indeed in most other countries, reorganization is rare unless by the substantial infusion of governmental monies.

The Chapter 11 provisions of the United States Bankruptcy Code work well largely because the "delicate balance" of claims and priorities is further subjected to a negotiating process which impels each claimant or category of claimant to assess carefully the relative worth of their claims against the value of having the debtor emerge as a viable enterprise, thus preserving the going concern value of its assets, the jobs of ita employees, and the contribution of its products and services to its community. Trade creditors, for example, may logically determine to take a lesser amount for their pre-petition claims in the expectation that a viable customer will emerge from the Chapter 11 proceedings. Laborers and otber employeea will often agree to a variety of adjustments in their pre-petition claims and their post-petition requirements in order to preaerve the enterprise and the jobs aasociated with it. If a particular claimant or category of claims proves unduly recalcitrant, Chapter 11 empowers the courts in certain instances to compel the acceptance of rational results.

Legislation such as laat year's Eighth Priority to bank regulators distorts the process and thwarts the prospect for reorganization of Chapter 11 debtors. The bank regulators have acceaa to the bank's aaaets. Tbe excesa claim (tbat is, unpaid capital contributions from the non-bank operations of the debtor) is another category of claim which ahould be tempered by the Chapter 11 negotiating process. The requirement that a Chapter 11 debtor continue to pay the bank regulators (or the PBGC or any other "priority claimant") in full notwithstanding the effect of those payments on tbe availability of cash for current services to the post-petition debtor, or the effect on banks or other funding sources asked to supply operating caah to the debtor, simply encourages the bank regulators or the PBGC or the retired employees or whomever else has the priority to be recalcitrant, witb tbe effect that the others will withhold their goods, services, or financing. If funds are unavailable to pay for the continuing operations of the debtor, neither the banking syatem nor anyone else will benefit. If the banking syatem is given full payment of ita pre-petition contract benefits during the Chapter 11 administration, no other category of claimant will agree to scale down or defer its pre-petition claims or permit aasets to be expended to allow the post-petition operation to continue. The "Keep-Well" priority and mandated contract asaumption proviaions of last year's legislation aimply creates one category of entrenched claimant whose demand on limited assets will tend to encourage rigidity in every other claimant group.

The simple fact is that the Congressional comments accompanying the introduction of last year's legislation were off base. Those commenta suggest that in Chapter 11 reorganizations the competing claims are those of the employer company and its shareholders versus the claims of the banking authorities. That is simply not the case. The invariable bankruptcy policy -- a policy rooted in constitutional law principles -- is that the owners of a Chapter 11 debtor may not receive or retain anything of value under a plan of reorganization unless the various classes of creditors have been paid in full or have consented. (There is a judicially-created exception where the owners or shareholders put new value into the reorganization debtor for a continuing interest.) That rule, known as the "fair and equitable" rule, is the keystone of Section 1129, the confirmation section of the Bankruptcy Code, as it was of the Bankruptcy Act which preceded it.

The real competition is among the various classes of creditors, and that includes the current employees of a Chapter 11 company and those who now assert a right to high priority for bank regulatory payments. It should also be noted that most priority legislation will not have a significant adverse impact on Wall Street bankers or other secured creditors. The right of the secured creditors (usually banks, insurance companies, and other institutional investors) are essentially unaffected by the proposed legislation. The real victims would be the unsecured creditors and the prospect for reorganization: a prospect of the utmost significance to employees, to the communities in which the companies are located, and to our national economy.

<u>Retroactivity</u>

Most American laws are designed to operate prospectively. This is not the place for an extended exposition of the meaning of Article 1, Section 9, Clause 3 of the United States Constitution, which provides that no "Bill of Attainder or ex post facto Law shall be passed." The sense in that constitutional provision is that it is fundamentally unfair to change rights which existed, and on which citizens relied, prior to the time that Congress or another appropriate body changed the law.2/ When the Bankruptcy Reform Act of 1978 was enacted -- it was signed by President Carter in November

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2/ Or, in instances such as federal taxation, at least prior to the time the legislation was introduced into Congress.

1978 -- it was given an effective date of October 1, 1979, and all bankruptcy cases in existence prior to that date continued to be governed by the Bankruptcy Act of 1898.

During the time he served as Chairman of the House of Representatives' Judiciary Committee, Congressman Peter Rodino served as a bulwark against retroactive bankruptcy legislation, and the House staff responsive to him was particularly sensitive to attempts to violate the principle of "no retroactive legislation." A wise lobbyist pushing for bankruptcy legislation took care to avoid retroactivity because of staff and Congressional sensitivity. Today, a number of the bills introduced -- and several of those enacted -- provide for blatantly retroactive application. The most recent example is the 1990 "Eighth Priority for insured depository institutions" amendments described in this Report. Effectively, that priority means that banks which have lent under unsecured lines of credit, or bondholders who advanced funds for unsecured bonds (virtually all public bonds are unsecured in this day and age), to companies which subsequently acquired banks or savings and loan associations which eventually dragged the entire enterprise into bankruptcy, will, by enactment of a later law, find themselves entirely wiped out because the federal government has taken all of the assets of the debtor to satisfy the requirements of the newly enacted Eighth Priority. Thus, lenders who thought they would at least share pro rata with all others who had the misfortune of lending to or relying upon the now bankrupt company, will find themselves wiped out.

<u>Open Congressional Committee Hearings on Well-Publicized Notice</u>

Open deliberation preceding the enactment of legislation which affects thousands of cases should be a prerequisite for any legislation. The statement seems so obvious, and would seem so central an idea in our Congressional system, that it is surprising that it has to be repeated. Nevertheless, Bankruptcy Code amendments have emerged with no substantial input from the bar, from the public, or from anyone other than the special interest group pressing the legislation.

Open hearings on reasonable notice is a clear requirement in an open society. We are not now speaking about declarations of war or matters as to which most legislators have a deep understanding of the needs of their constituents. The Bankruptcy Code is a tightly constructed piece of technical legislation. The interplay and secondary meanings of words and provisions generally escapes those who are not schooled in the field (and many who are). In this respect, it is similar to the securities laws, the antitrust laws and other fields where an understanding of the process cannot be gleaned from a reading of the text. In many respects this is even more true in the bankruptcy process than in most others. Bankruptcy is a field in which procedure is substance. A cash collateral arrangement at the inception of a bankruptcy case will sometimes make inevitable a particular outcome for the entire proceeding. Allowing relief from stay will often dictate whether or not a debtor can reorganize. A bankruptcy court determination of how to compute certain types of claims may dictate whether a pre-bankruptcy workout is feasible. The bankruptcy treatment of a particular type of claim may determine whether a high-risk business transaction will take place at all. The point is that Bankruptcy Code provisions have effects not only in bankruptcy proceedings, but often determine whether a pre-bankruptcy workout is possible, or whether a business transaction will be entered into in the first place.

A legislative pattern had emerged in the Congress where all legislation touching upon the Bankruptcy Code (or the Bankruptcy Act before it) required the separate consideration of the Judiciary Committees of the Congress, and those committees generally insisted on at least one full set of open hearings, following notice to the interested constituencies. Groups like the National Bankruptcy Conference, the American Bar Association, the AFL-CIO, the American Bankers Association and the National Association of Manufacturers were among those regularly invited to comment. Bankruptcy legislation is not emergency legislation (except when one wishes to utilize it retroactively). Many areas should probably be left for judicial development before a rush to legislation. At a minimum, there should be consideration of the effects, alternatives, and operation of any Code provision.

In the last couple of years, that system has broken down. When hearings have been held, many have been on less than ten days' notice. Legislation such as the 1990 Eighth Priority was preceded by no known public hearings. One problem is that banking or labor legislation which emerges from a Congressional committee other than the Judiciary Committee, sometimes casually "throws in" sn amendment to the Bankruptcy Code. A reasonable monitoring process to bring that to the attention of the Judiciary Committees was one way of avoiding the problem. It is obvious todsy that an additional reminder is required.

Recent Experience

Following the bsnkruptcy filing of Esstern Air Lines in 1989, a number of hills were introduced -- designed to apply retroactively to the Eastern Air Lines case, and some to apply to other sirlines -- which would have required that all of the compsnies affilisted with the airline company be "substantively consolidsted," i.e., that all effectively be merged for purposes of making assets available to all creditors. Thus, affiliated companies that owned hotels or that owned computer systems, and on whose financial statements various creditors had relied in making loans or advancing credit, would suddenly find themselves part of a merged airline and related compsny group where the collective hargsining and other obligations overwhelmed every other ssset or line of business. Similar Congressional reactions occurred in 1986 after the filing of the LTV cases. Retroactivity had hecome fsshionable.

Since 1987, the Pension Benefit Guaranty Corporation, a governmental agency created to guarantee obligations for which neither the Congress nor companies adopting covered retirement programs had made effective provision, began to introduce legislation to provide the PBGC a priority in bankruptcy over the clsims of all other creditors. In many instances the aggregate claim of the PBGC would wipe out the prospect of any other creditor receiving any substantial distribution. Not to be outdone, in 1988 a Federal Debt Collection Procedures Act was introduced which would have provided similar priority treatment for "all debts owed to the United States," which in turn was defined as including substantially the entire gamut of governmental entities and federal corporations: environmental claims, hanking claims, the military and defense establishments, and a variety of subjects as yet unspecified. Similar legislation was again introduced in 1990. The Department of Justice and other proponents eventually understood the danger to the bankruptcy system posed by such a priority grant, and eliminated the priority provisions from the Federal Debt Collection Procedures Act of 1990 as eventually enacted. Thereafter, the banking regulators picked up on the Eighth Priority and had it enacted -- without public hearing and without notice to anyone -- in the secret and closing days of the 101st Congress.

What is sought is not a resolution against amending the Bankruptcy Code. No statute -- singular or comprehensive -- is perfect. Amendments are called for over time to correct legislative errors or errors made in the course of judicial application. Amendments are necessary to meet situations not envisioned or focused upon by the legislators when the original statutes were passed. However, special interest legislation which upsets the delicate balance of rights by establishing priorities for one group of politically effective interests contrary to the general principle of equality of distribution, or which is retroactive in effect, or which is advanced without the full hearings inherent in the normal legislative processes, should be stopped.

Respectfully submitted,

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